THE NEW PARTNERSHIP FOR AFRICA'S DEVELOPMENT

Macroeconomics, Institutions, and Poverty

Editor SALEH M. NSOULI

AFRICAN DEVELOPMENT BANK • INTERNATIONAL MONETARY FUND • WORLD BANK

JOINT AFRICA INSTITUTE

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Contents

Foreword. v

Acknowledgments vii

1. Introduction: NEPAD—A New Vision
   Saleh M. Nsouli and Norbert Funke 1

2. Opening Remarks
   Saleh M. Nsouli and Omar Kabbaj 9

3. Keynote Address
   Abdoulaye Wade 18

4. The New Partnership for Africa's Development: Opportunities and Challenges
   Norbert Funke and Saleh M. Nsouli 23

5. Poverty and Its Eradication
   T. N. Srinivasan 57

6. Promoting Trade: Regional Integration and the Global Economy
   F. O. Ndukwe. 88

7. Policy Reform and Foreign Direct Investment in Africa: Absolute Progress But Relative Decline
   Elizabeth Asiedu. 116

8. The NEPAD Economic and Corporate Governance Initiative: Building Institutions for Sustainable Development
   Soumana Sako 126

9. The Role of Regional Institutions in Achieving NEPAD's Goals
   Charles Konan Banny 142

10. What the IMF Can Do to Support NEPAD
    Abdoulaye Bio-Tchané 147

11. Developments and Actions in NEPAD's Implementation
    Isaac Aluko-Olokun 153

12. Summing Up: Taking Stock and Future Steps
    Evangelos A. Calamitsis. 160

Contributors 169

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Foreword

The New Partnership for Africa's Development (NEPAD) represents a new vision and strategic framework for Africa's economic and social development. Adopted in 2001, NEPAD has provided renewed impetus to efforts focused on accelerating growth, reducing poverty, and integrating Africa into the world economy, consistent with the Millennium Development Goals. NEPAD's objectives are ambitious: a targeted annual rate of growth of about 7 percent and a reduction by half of the population living in extreme poverty by 2015. These are by no means easy targets to achieve. However, substantial progress is possible if all parties involved commit to the NEPAD spirit and implement appropriate policy reforms.

To discuss important elements of success for NEPAD, the Joint Africa Institute, which is a collaborative institution established by the African Development Bank, the International Monetary Fund, and the World Bank, held a high-level seminar in Dakar during December 9–11, 2002. The seminar brought together ministers, governors, and other senior officials from some 20 African countries, as well as donor representatives, academics, and staff from regional and international institutions. The selected seminar contributions in this volume cover a broad range of issues, focusing on the challenges confronting NEPAD in reducing poverty, promoting trade, attracting capital flows, and effecting institutional reforms. They help to identify how the principles embodied in NEPAD can be transformed into policy actions and be successfully implemented.

The chapters in this volume underscore that NEPAD provides a continent-wide framework but, at the same time, that each country will have to formulate its own development strategy, with a comprehensive program of action that best suits its specific circumstances. The effective implementation of proven good practices, both in national policy agendas and in regional and international cooperation, will be central to progress on the NEPAD initiative. All segments of the population must understand and take ownership of NEPAD's goals and the requisite actions.

A two-pillar approach can form an important basis for the success of NEPAD—African countries implementing appropriate domestic policies and the international community providing adequate support. Increased international support will also be needed for capacity and

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institution building in Africa. Our three institutions—the African Development Bank, the International Monetary Fund, and the World Bank—fully support the ongoing efforts. We hope that this volume will contribute to deepening the understanding of the opportunities offered by and the challenges facing NEPAD. The tasks that remain are enormous and require unprecedented efforts by all parties involved.

Omar Kabbaj
President
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The World Bank

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Acknowledgments

Many people contributed to the success of the high-level seminar, "The New Partnership for Africa's Development" held in Dakar, Senegal, on December 9–11, 2002, and to the making of this book. I want to express my appreciation to the seminar participants whose presentations and interventions made for such a lively discussion and to the authors for the insightful set of papers published in this volume.

I am grateful to the Joint Africa Institute—a collaborative effort of the African Development Bank, the International Monetary Fund, and the World Bank—for organizing the seminar. The staff of the Joint Africa Institute, and particularly its director, Michael Bauer, spared no effort in making the seminar a success.

I greatly appreciate the assistance and support of Evangelos Calamitsis, former director of the IMF African Department, and Norbert Funke, currently senior economist in the IMF African Department, in the organization of the seminar and for reviewing these papers.

I would also like to thank Farah Ebrahimi, Ian McDonald, and Sheldon Annis for their excellent editing of this volume. Special thanks are due to Marie-Therese Culp for her hard work leading to the preparation of the seminar and then this manuscript.

—Saleh M. Nsouli

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1

Introduction: NEPAD—A New Vision

Saleh M. Nsouli and Norbert Funke

What will determine the success of the New Partnership for Africa's Development (NEPAD)? Which policies and measures envisaged under NEPAD need to receive highest priority? Who should be responsible for which task? What can be done to overcome potential risks and to speed up the implementation of action plans? These underlying questions are the themes that reverberate throughout this volume.

Adopted in 2001, NEPAD represents a new vision for the development of Africa. It has three long-term objectives: to eradicate poverty; to place African countries, both individually and collectively, on a path of sustainable growth and development; and to ensure Africa's full integration and active participation in the world economy. It aims at achieving the United Nations Millennium Development Goals for 2015.

This conference volume on NEPAD stems from a high-level seminar held in Dakar during December 9–11, 2002, organized by the IMF Institute in the context of the program of the Joint Africa Institute (JAI). The seminar brought together ministers, governors, and other senior officials from some 20 African countries, as well as donor representatives, academics, and staff from regional and international institutions. This book includes a selection of the papers presented at this conference. The papers focus on the challenges confronting NEPAD in reducing poverty, promoting trade, attracting capital flows, and effecting institutional reforms. Although it is recognized that the achievement of poverty reduction and sustainable development will also depend importantly on peace, security, democracy, and human rights, the focus in

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this book is on issues that are closely linked to the core mandate of the International Monetary Fund (IMF).

Opening Remarks—The Challenges

In their opening remarks, Saleh M. Nsouli, Deputy Director of the IMF Institute; Omar Kabbaj, President of the African Development Bank (AfDB); and Abdoulaye Wade, President of the Republic of Senegal, place NEPAD in a wider historical context, review the objectives of NEPAD, and identify the major challenges.

Nsouli argues that although previous continent-wide initiatives have not led to the desired results, there is hope this time for a different outcome. This expectation is based on NEPAD's new building blocks, which are critical for successful reform. According to Nsouli, what is new about NEPAD is the extent of African ownership and leadership of the development agenda. Also new is the wide acceptance that good governance plays a key role in fostering growth and reducing poverty, and the extent of international appreciation for this initiative. Despite the enthusiasm that NEPAD has already attracted, the move from the existing basic framework to an operational blueprint will depend to a large extent on the resolve of the individual countries and the steps that they take, and on appropriate support by the international community.

Kabbaj focuses on the AfDB's approach to NEPAD. While emphasizing that African countries must take charge of their own development process, he acknowledges the decisive role that external assistance will play in Africa's development efforts. Kabbaj reviews AfDB's involvement and explains that AfDB has been committed to providing the requisite technical assistance right from the outset. According to Kabbaj, AfDB has been called upon by African heads of state to play a lead role in two areas, namely, infrastructure development, and banking and financial regulations. The AfDB has also indicated its willingness to contribute to the peer review process. Furthermore, AfDB is working with the Economic Commission for Africa on governance issues. In his assessment, Kabbaj notes that the NEPAD initiative is well suited to facilitate the efforts of African countries to achieve rapid and sustainable development. However, apart from the critical role of the African countries themselves, development institutions—be they national, regional, or international—must strengthen their commitments in favor of NEPAD to provide the necessary assistance.

President Wade begins his remarks with an overview of the objectives and the guiding principles of NEPAD. His subsequent discussion of ongoing initiatives under the NEPAD umbrella provides evidence of

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the large momentum that the NEPAD has already achieved. He emphasizes the importance of rapidly bridging the gap between Africa and the industrialized countries, taking into account an appropriate period for the various action plans. In closing, President Wade identifies four critical issues for NEPAD's success: mobilizing development financing, tackling African debt, developing human resources, and fostering public-private partnerships. He argues that the traditional sources of public and private capital flows to Africa need to be augmented and that further analyses of the dynamics of African debt are needed. Also, appropriate incentives should be considered in order to reverse the trend of the flight of intellectual capital from Africa, especially the loss of high-level expertise. Lastly, he emphasizes that Africa should not overlook the trend toward the reorganization of public sector–private sector relationships, as already observed in industrialized countries and in a number of emerging markets, such as Malaysia, Mauritius, and Tunisia.

Overview of Macroeconomic Issues

In Chapter 4, Norbert Funke and Saleh Nsouli begin with a review of Africa's performance during the last decade. They then present a simple framework for evaluating NEPAD. They argue that poverty reduction can be seen as the partnership's overarching objective. Increased growth is a necessary but insufficient condition for tackling poverty. In their view, realizing the targeted average annual growth rate of real GDP of some 7 percent will require unprecedented efforts and sustained implementation of sound macroeconomic policies and structural and institutional reforms. With the help of their framework, Funke and Nsouli identify a number of risks facing NEPAD and point to factors that the authorities will need to take into account to minimize these risks. They emphasize that in moving from vision to action, it remains essential to broaden and deepen discussions with the wider public, to avoid duplication of existing efforts, to strengthen the monitoring of progress, and to clarify further the responsibilities of NEPAD structures.

Reducing Poverty

In Chapter 5, T. N. Srinivasan analyzes the determinants of poverty; discusses mechanisms for eradicating poverty; and looks at the linkages among growth, openness, globalization, and poverty. For analytical purposes, he defines the poor as those lacking resources to acquire what he calls a "poverty bundle of goods and services." He identifies two broad approaches to poverty alleviation: redistributing assets or income, or both, from the

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rich to the poor; and raising the returns on the assets of the poor. His analysis shows that redistributive policies, even if beneficial in the short and the long run, are politically difficult to implement. Therefore, it is important to identify and implement appropriate policies that can have a major influence on the socioeconomic-political framework in which the poor make their decisions. Srinivasan concludes that policies that are not linked directly to poverty reduction at first glance may nonetheless be important for improving the situation of the poor. Macroeconomic stability and openness are among these essential policies.

Integration into the World Economy

In Chapter 6, F. O. Ndukwe analyzes how a successful implementation of NEPAD can contribute to enhancing Africa's global competitiveness. A guiding principle of NEPAD is acceleration and deepening of regional and continental economic cooperation and integration. Ndukwe reviews Africa's trade performance and regimes, analyzes the constraints on regional integration and intra-African trade, and gives an overview of recent measures and initiatives to alleviate these constraints. He shows that many African countries have already made substantial progress in trade liberalization, but they need to absorb the progress made so far. Ndukwe's analysis suggests that Africa can achieve better integration by taking several measures. Critical among these are the need for the consistent implementation of sound macroeconomic policies and the rationalization and transformation of African integration blocs into effective, open, and large markets.

In Chapter 7, Elizabeth Asiedu analyzes the critical role of foreign direct investment (FDI). NEPAD's framework indicates that Africa will need to fill an annual resource gap of $64 billion, equivalent to some 12 percent of the continent's GDP, to achieve the Millennium Development Goals. Although this will require increasing domestic saving, a substantial part of the needed resources will have to come from abroad. Asiedu identifies the major determinants of FDI and examines whether Africa is different. The results show that an absolute improvement in the investment climate in Africa has not been sufficient to attract a large share of global FDI in a highly competitive environment. Although sub-Saharan Africa has improved its infrastructure, liberalized trade, and reformed its institutions, the degree of reform has been mediocre compared with other developing countries. As a consequence, relative to other regions, sub-Saharan Africa has become less attractive for FDI over time. Asiedu concludes that it is not enough only to im-

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prove Africa's policy environment in absolute terms; improvements need to be made in relative terms as well.

Economic and Corporate Governance

Soumana Sako emphasizes in Chapter 8 that NEPAD rightly stresses the importance of good governance and a sound institutional framework. He outlines the institutional requirements underpinning the political, economic, and corporate governance initiative of NEPAD as it seeks to tackle some of the key institutional and policy constraints facing Africa. Sako shows that a well-functioning market economy needs to be supported by various types of institutions. His analysis distinguishes among five different types of institutions: property rights, regulatory institutions, institutions for macroeconomic stabilization, institutions for social insurance, and institutions for conflict management. Although all are important, special emphasis needs to be given to ensure the rule of law. Sako concludes his analysis with a set of policy questions and issues and some strategic directions for the development of action plans for institution building.

Clarifying Responsibilities and Identifying Priorities

In Chapter 9, Charles Konan Banny reviews the conceptual framework of NEPAD with regard to the division of responsibilities among three levels: national, regional, and continent-wide. He argues that once NEPAD has been properly implemented at the national level, regional institutions can play a valuable role in advancing NEPAD's objectives. Banny shows that regional institutions can also play an important role in monitoring NEPAD's implementation. According to his assessment, NEPAD will succeed to the degree that the primary stakeholders can exercise self-discipline as well as mutual supervision of macroeconomic policy in the context of clearly codified mechanisms accepted by all. Peer review of performance and policies will help identify, assess, and disseminate best practices and track progress in the attainment of objectives. Based on the experience of his institution, Governor Banny concludes by analyzing how best to design a framework for a peer review of policies.

In Chapter 10, Abdoulaye Bio-Tchané discusses how international financial institutions can contribute to the success of NEPAD. Focusing on the example of the IMF, his analysis highlights how the IMF helps to support NEPAD in at least three areas: the formulation of guidelines for national economic policies, the facilitation of regional—and ultimately

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pan-African—integration, and the establishment of a peer review mechanism. Within each theme, he suggests specific roles that the IMF could and should play, as well as some general principles that NEPAD might pursue. With respect to economic policymaking, Bio-Tchané looks at the links among the Poverty Reduction Strategy Papers (PRSPs), the IMF's Poverty Reduction and Growth Facility, capacity building, and NEPAD's objective of poverty reduction. Turning to the potential role of IMF support for NEPAD in the area of regional integration, Bio-Tchané reviews IMF experience of support for the West African Economic and Monetary Union (WAEMU) and its support for the Central African Economic and Monetary Community (CAEMC). He views the African Peer Review Mechanism (APRM) as close to the core of what the IMF has been trying to achieve over its more than 50 years. Therefore, he suggests that NEPAD may wish to adopt some of the consultation and review mechanisms of the IMF, as well as its analytical approach.

In Chapter 11, Isaac Aluko-Olokun reviews important developments in NEPAD's implementation process. He stresses that NEPAD is not an implementing agency. Implementation will be carried out at various levels, but individual countries and their actions constitute the nuclei of all programs and their implementation. He then looks at priorities and identifies crucial actions in a number of areas. Aluko-Olokun recognizes an urgent need to address conflict prevention, resolution, and management issues, including the capacity to undertake peace-support operations, as well as to build early-warning capacity. He also stresses the importance of making the APRM operational quickly in order to address market access issues, to pursue the issue of enhanced debt relief, and to improve the communication of NEPAD, to garner broader and stronger support from the general public. Aluko-Olokun emphasizes that NEPAD does not seek to replace or compete with existing international initiatives and programs, but rather to consciously establish linkages and synergies between NEPAD and existing initiatives.

Summing Up

A striking consensus emerged during the conference. In Chapter 12, Evangelos Calamitsis pulls together the major conference themes. He stresses that NEPAD has attracted worldwide interest and enthusiasm because of its new vision for a better future and its focus on a new partnership between Africa and the international community. He emphasizes that the discussions have shown that African countries and institutions need to redouble their efforts in order to achieve NEPAD's goals of poverty reduction and sustainable development. In the context of

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nationally owned development strategies, it remains essential to consolidate sound macroeconomic conditions and strengthen competitiveness, to promote trade and regional economic integration, to foster private investment, to improve health and education, to expand infrastructure facilities and boost rural development, and to enhance capacity building and institutional reforms. Calamitsis observes that the implementation of NEPAD's strategic framework will depend largely on the resolve of individual countries and the steps they take. Every African country will have to design its own development blueprint, consistent with NEPAD's goals. In light of individual country circumstances, this will involve setting more-specific quantitative objectives, improving governance, pursuing requisite macroeconomic policies and structural reforms, strengthening institutional capacity for effective program implementation and integration into the world economy, and transforming partnerships with donors through mutual commitments and accountability. NEPAD provides a unique opportunity for African countries to succeed by taking full control of the development agenda, working more closely together, and cooperating more effectively with the international community.

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Since the high-level seminar in late 2002, several steps have been taken to further NEPAD. The organizational structure has been refined and linkages with international partners have been established. Many workshops, meetings, and conferences have been held on NEPAD issues. Progress has been made in identifying priority areas, including in infrastructure and agriculture. Significant progress has also been made in setting up the APRM. In 2003, the APR Panel of Eminent Persons was established to provide oversight to, assist, and help organize the APR process. In February 2004, the APR Forum—the highest decision-making body of the APRM, consisting of participating heads of state and governments—held its first summit meeting, and the first reviews are about to start. Despite important progress, however, experience also shows that setting up an appropriate structure and getting commitment from all countries takes time. As for the APR Forum, only 16 countries had subscribed to the voluntary peer review process.

At the current rate of progress, the Millennium Development Goals are unlikely to be met by 2015, a reality already acknowledged in NEPAD's 2003 progress report. As highlighted in this chapter, many of the challenges that clearly face NEPAD were discussed during the high-level seminar, including the involvement of regional bodies in the implementation of NEPAD, public support and awareness, and continued

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assistance from the international community based on demonstrated results. We hope that this book will offer useful insights into this process and help to focus on big policy issues, in particular those that fall within the core areas of the IMF mandate.

The papers in this book underscore the complexities of NEPAD's goals. The analyses show that the objectives of the partnership are ambitious—as they should be. Achieving these objectives will require unprecedented efforts. The discussions make clear that NEPAD provides a framework within which *each* African country will set its own development strategy with a comprehensive program of action that best suits its specific circumstances. The importance of coordinating actions at the regional level is also emphasized, and strong international support will be needed, particularly in the areas of aid, trade, and debt relief. However, such support will not be forthcoming—or it will be much less than needed—if African countries do not deliver on the major commitments embodied in NEPAD's strategic framework. The chapters in this book are an attempt to help deepen this understanding.

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2

Opening Remarks

Saleh M. Nsouli and Omar Kabbaj

Welcoming Address, Saleh M. Nsouli

On behalf of the International Monetary Fund, it is a great pleasure to welcome you to this high-level seminar on the New Partnership for Africa's Development (NEPAD), and to thank you for taking part in the discussions over the next three days.

I am especially pleased and honored that His Excellency the President of the Republic of Senegal has graciously agreed to be with us in today's opening session and to deliver the keynote address. As all of you know, President Abdoulaye Wade is a leading architect of NEPAD, and Senegal remains pivotal in its support of this new initiative. It is particularly fitting, therefore, that this seminar takes place here in Dakar.

I am also delighted that the president of the African Development Bank, Mr. Omar Kabbaj, has joined us. It is his interest in capacity building in Africa that led to the establishment of the Joint Africa Institute (JAI) as a collaborative effort of the African Development Bank (AfDB), the World Bank, and the IMF.

I hope that last night's reception by the JAI has given you a good opportunity to meet each other and renew previous contacts, as well as to get to know Mr. Michael Bauer, the new director of the JAI. This seminar very much exemplifies the interests and efforts of the JAI, which has always collaborated closely with its three founding institutions. I would like to take this opportunity to thank Mr. Bauer and his colleagues at the JAI, as well as my own colleagues at the IMF, particularly Mr. Norbert Funke and our resident representative in Dakar, Mr. Koffi Yao, for all their work in organizing this seminar. I also wish to thank

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the Senegalese authorities for their warm welcome and splendid cooperation in this undertaking.

Despite the progress made by an increasing number of African countries since the early 1990s toward macroeconomic stability and reform, Africa's overall growth performance has remained inadequate, and poverty is still widespread. In sub-Saharan Africa, almost half of the population today lives on less than $1 a day. There can be no doubt that reducing poverty should be the highest priority.

Launched in 2001, NEPAD represents a promising vehicle for achieving faster growth and poverty reduction in Africa, based on sound political, economic, social, and environmental policies and reforms. Although previous continent-wide initiatives have not achieved the desired results, there is hope that this time the outcome will be different. This expectation is based on three new building blocks that are critical for successful reform:

- The extent to which ownership and leadership of the development agenda is now African, anchored in the recognition that countries themselves have primary responsibility for improving economic and social conditions
- The wide, new acceptance of the role of good governance in fostering growth and reducing poverty
- The new appreciation and extent of support for this initiative by the international community.

It is encouraging to see how much enthusiasm NEPAD has already attracted. A critical issue now is how NEPAD's strategic framework will be effectively translated into action. The move from a basic framework to an operational blueprint will depend largely on the resolve of individual countries and the steps they take—including setting more-specific quantitative objectives, pursuing consistent macroeconomic policies and structural reforms, enhancing capacity building and strengthening institutions, successfully implementing the African Peer Review Mechanism (APRM), and transforming partnerships with donors through mutual commitments and accountability.

Many, but not all, of these issues are closely linked to the core mandate of the IMF. Recognizing that poverty reduction and sustainable development will depend importantly on peace, security, democracy, and human rights, this seminar will focus on governance and policy issues, including the policies and reforms to consolidate sound macroeconomic conditions, foster trade and regional integration, attract foreign direct investment, and build effective institutions.

I believe that there is substantial convergence between Africa and the international community on the themes and issues that need to be

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addressed. Yet many questions remain: What exactly needs to be done? Who should do what? What do we expect from one another?

IMF's former managing director, Horst Köhler, has emphasized, "The IMF is committed to support NEPAD wholeheartedly." Apart from its financial assistance to many African countries, notably through the concessional Poverty Reduction and Growth Facility, the IMF has responded to NEPAD's requirements by intensifying its support of capacity-building efforts in the region. The IMF Institute has expanded its training activities in Africa to help build up the capacity of government officials to design and implement macroeconomic policies, including through the JAI. Furthermore, it has recently inaugurated the first of five African Regional Technical Assistance Centers. The IMF is also pursuing its work on internationally agreed codes and standards of good practice, which African leaders have endorsed, and is preparing the related country reports. In addition, together with the World Bank, the IMF is implementing the enhanced Heavily Indebted Poor Countries (HIPC) initiative, providing substantial debt relief to African countries and thereby releasing more resources for economic and social development purposes.

Although NEPAD offers unique opportunities to African countries, both individually and collectively, it also faces major challenges. It is my hope that this seminar will allow us to gain a deeper understanding of key questions such as these:

- Which policies and measures now envisaged under NEPAD need to receive highest priority?
- Which critical reform elements have not yet received sufficient attention?
- What can be done to overcome potential risks and speed up implementation of programs?
- How can the APRM be carried out effectively?
- How should responsibilities be shared among countries, regional communities and institutions, bilateral donors, and international organizations?
- How can the expectations and actions of Africa best be aligned with those of the international community?

I look forward to stimulating presentations and discussions on these and related issues.

Opening Address, Omar Kabbaj

I shall begin by focusing on the African Development Bank's approach to NEPAD, touching upon the major challenges that NEPAD

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must address to ensure its success. It is appropriate to emphasize once more the support that AfDB is giving to the NEPAD, as well as the assistance program we are planning.

What Direction Should NEPAD Take?

Throughout and beyond Africa, NEPAD has been hailed as a major initiative capable of revitalizing and refocusing our development efforts. There are several reasons for the esteem accorded NEPAD since its inception:

- First, NEPAD is something we can call our own. It epitomizes the determination of African policymakers to take ownership of the development process in individual countries and the continent as a whole. Experience of the past decade has shown that ownership is a prerequisite for a successful development initiative. And a key ingredient of such ownership—and this is a first for our countries—is the agreement on establishing the APRM to monitor progress in implementing agreed-upon development programs.
- Second, NEPAD reflects not only an unflinching assessment of the current challenges confronting the development process in Africa. It also reflects the new realities emerging directly from the rapid globalization of the world economy. This approach has enabled African policymakers to design a development program that is simultaneously realistic and pragmatic, and consistent with lessons from the recent past. Observe, for example, the high priority that NEPAD attaches to judicious macroeconomic policy, the importance of mobilizing a substantial volume of domestic resources, and the private sector's key role as an engine of growth.
- Finally, NEPAD reflects key values and principles that must underpin the development process in Africa. NEPAD has highlighted the crucial importance of good governance and the need to honor democratic principles and human rights, while focusing on the quest for a peaceful resolution to the many conflicts currently affecting the African continent.

While emphasizing that African countries must absolutely take charge of their own development process, NEPAD acknowledges the decisive role that external assistance will continue to play. Accordingly, it has called for the establishment of a new type of partnership between African countries and the donor community, predicated on shared principles and a firm commitment to meet their respective obligations and

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achieve the agreed-upon objectives. I am pleased to observe that our call has been heeded and has garnered substantial international support. Over the past 18 months, NEPAD has gained backing from a number of organizations and countries, including the European Union, the United States, Japan, and the Scandinavian countries. The endorsement received from the leadership of the Group of Eight (G–8) countries at the Kananaskis Summit in Canada, as embodied in the G–8 Africa Action Plan, is a further indication of the broad-based support for NEPAD.

The assistance provided by Africa's development partners will be assessed in three areas. First, we must measure the progress achieved in boosting official development assistance (ODA). Second, we must determine whether the indebtedness of Africa's poor countries has been brought down to a manageable level. Third, we must examine the degree of openness in industrial country markets as well as the attendant opportunities for African exports. Major setbacks notwithstanding, progress in these three key areas has been achieved.

We welcome the commitment by donors to increase by $12 billion the annual contributions of ODA by 2006, half of which will be allocated for Africa. However, this figure falls short of recent estimates of the resources African countries will need to expedite attainment of the Millennium Development Goals. For example, the 2002 *Global Poverty Report*, prepared by a team from the international financial institutions and led by AfDB, estimates that the additional requirements of 30 African countries with reform programs are approximately $20–25 billion a year. We trust that the donor community will continue to increase its ODA in order to accommodate the poorest countries' need for concessional resources.

In the area of debt relief, the Heavily Indebted Poor Countries (HIPC) initiative—in which the African Development Bank Group plays a major role—has begun to achieve appreciable reductions in the debt burdens of the poorest countries. Twenty-two African countries have thus far met the eligibility criteria for debt relief. We welcome the latest additional contributions announced by donors to ensure full funding for the HIPC initiative. However, given the recent unfavorable trends in commodity prices, we must continually review the debt relief accorded the poor countries to help keep their indebtedness within manageable bounds.

With respect to broadening access to markets and abolishing industrial country trade subsidies that stand in the way of African exports, we hope that the pledge to work toward the duty-free and quota-free

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importation of all products originating in developing countries will materialize as quickly as possible. We are therefore encouraged by recent trade initiatives such as the European Union's Everything-but-Arms Initiative, and the African Growth and Opportunity Act (AGOA) signed into law in the United States. We also welcome the agreement to launch the Doha Development Agenda in the context of the World Trade Organization negotiations. We cannot hide, however, our disappointment with the retention and, in some cases, the strengthening of key domestic agricultural subsidies paid by the European Union and the United States. We urge our development partners to reconsider their decision, which blocks the growth of agricultural exports from Africa and other developing countries.

We are encouraged to observe how quickly NEPAD has won support for its ideas and objectives among African countries and their development partners. Nevertheless, a number of challenges lie ahead. Allow me to review the most important.

First, NEPAD's success is clearly attributable to the fact that our policymakers and countries are committed to the partnership's economic and policy ideals. We therefore welcome the agreement recently reached by the Heads of State Implementation Committee entrusted with implementing NEPAD, with particular reference to the jurisdiction and arrangements for implementation of the APRM. The fact that the APRM will focus on political, economic, and institutional governance and can already claim an initial group of 12 member countries is a genuine breakthrough. I would like to point out, however, that proper and effective functioning of the APRM is key to the credibility of the entire NEPAD initiative.

Second, the goals, ideals, and action programs of NEPAD must be disseminated as widely as possible. This is essential if NEPAD is to enlist the broad-based support of civil society and private sector organizations on the African continent and elsewhere. Major initiatives have already been adopted, such as the private sector forum organized by the Senegalese government in early 2002 and the stakeholder consultations organized by the African Development Bank. Clearly, however, much remains to be done.

Third, NEPAD's success will depend on continued support for African countries from the international community. As I have indicated, key steps have been taken in this direction, including actions to increase ODA, reduce debt, and expand market access. We cherish the hope that the international community will commit to increased funding in these and other areas so that our countries can achieve NEPAD's objectives.

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The African Development Bank and NEPAD

I would like to review the support that AfDB has given NEPAD, as well as other actions that AfDB plans to take in the near future to benefit NEPAD. Our efforts in this area reflect our conviction that the success of this important initiative requires the full support and involvement of African regional and subregional organizations; it is also our belief that the goals of NEPAD are consistent with the AfDB's philosophy.

The NEPAD has identified a number of priority action areas that focus on the need to bridge the gaps between Africa and other developing regions. Such a strategy is in keeping with AfDB's philosophy, which is geared essentially toward reducing poverty and promoting sustainable economic development. In addition, at the national level, AfDB's philosophy focuses on agriculture and rural development, education, health, good governance, and private sector promotion. At the regional level, AfDB emphasizes cooperation and integration. The AfDB also seeks to incorporate gender equity and sustainable environmental management into all its operations. This explains why NEPAD is giving a fresh impetus to our programs, particularly those aimed at stimulating economic cooperation and integration at the subregional level and across the African continent. For all these reasons, AfDB has been committed to providing the requisite technical assistance right from the start.

The Committee of Heads of State responsible for implementing NEPAD has called upon AfDB to play a lead role in two areas, namely infrastructure and banking and financial regulations. Furthermore, AfDB is working with the Economic Commission for Africa on governance issues.

With regard to infrastructure, AfDB has prepared a short-term action plan encompassing a list of priority investments and a package of regulatory and institutional reform measures required to promote the NEPAD initiative. This plan was submitted to the NEPAD implementation committee, which endorsed the plan in full. We are well aware that, in the field of infrastructure, full private sector participation will be essential, given the vast resources required to carry out the investments involved. Accordingly, AfDB has launched a number of initiatives to encourage partnerships between the public and the private sectors. We have high hopes that these initiatives will strengthen AfDB's catalytic role in the implementation of NEPAD in general and in the development of physical infrastructure in particular.

Moreover, we have designed a mechanism to facilitate the implementation of banking and financial regulations within regional member countries. This mechanism was reviewed and endorsed by the governors of the African central banks and representatives of finance ministries

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during a workshop at our annual meetings in Addis Ababa, May 2002. In addition, AfDB has submitted to the NEPAD secretariat a draft paper on money laundering.

The AfDB has also adopted a number of initiatives in support of NEPAD, in particular by organizing a NEPAD stakeholder consultation to exchange views on strengthening the role of nongovernmental and civil society organizations. Moreover, AfDB devoted the symposium at its most recent annual meetings to NEPAD, in order to discuss other ways of advancing the NEPAD initiative.

In the months ahead, AfDB will continue to work closely with the NEPAD steering committee to fine-tune the action plans that AfDB has prepared in the areas of infrastructure and banking and financial regulations. The AfDB plans to set up a small unit headed by experts to focus on NEPAD-related activities. The AfDB is also willing to designate an infrastructure expert to work with the NEPAD secretariat and to assist it in coordinating activities related to infrastructure. In this connection, I wish to thank the Canadian government for its pledge of Can$10 million to strengthen the capacity of regional economic associations to design and implement infrastructure projects.

In addition to infrastructure and banking and financial regulations, we have indicated our willingness to contribute to the peer review process in the areas of economic and corporate governance. In this respect, the country economic studies contained in the *African Economic Outlook,* a publication produced in cooperation with the OECD Development Centre, may prove a source of useful data and analysis.

Along with technical assistance, AfDB stands ready to assist NEPAD in mobilizing resources to support the development efforts of regional member countries, whether in connection with national programs or with NEPAD's own strategy. The successful outcome of the Ninth Replenishment of the African Development Fund assured us that AfDB Group will continue to have effective access to substantial resources for financing poverty-reduction projects and programs in low-income member countries. With particular reference to the AfDB, we have allocated some $500 million for the financing of multinational projects. We expect to use this money to mobilize additional funds from other sources to complement regional integration efforts in the NEPAD environment and in other settings.

Conclusions

In closing, I would like to mention that NEPAD has favorably impressed policymakers as well as civil society and private sector organiza-

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tions in Africa and elsewhere. This, I believe, is largely attributable to NEPAD's clear vision and philosophy, as well as its guiding principles and ideals. The NEPAD initiative is eminently well suited to facilitate our countries' efforts to achieve rapid and sustainable development.

The NEPAD was launched at a time when the international community had taken a number of steps to support the development efforts of countries in Africa and other developing regions. These initiatives include adoption of the UN Millennium Development Goals; the pledge (made at the 2002 Monterrey Conference on Financing for Development) to boost ODA; the commitment to sustainable development (renewed at the 2002 Johannesburg Summit); as well as a variety of trade initiatives undertaken by the European Union, the United States, and the Doha Development Agenda.

African countries must seize the historic opportunity afforded by these initiatives. Furthermore, NEPAD should serve as the nexus for our efforts to expedite the implementation of our development action plans. Failure is not an option, so we must do everything in our power to succeed. Development institutions—be they national, regional, or international—must strengthen their commitments in favor of NEPAD to provide the necessary assistance. For its part, the African Development Bank stands ready to provide whatever support may be requested of it.

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3

Keynote Address

Abdoulaye Wade

This high-level seminar on the New Partnership for Africa's Development (NEPAD) deals with an especially topical issue at a time when the courageous people of Africa are making enormous sacrifices to free their continent from the clutches of chronic underdevelopment and reap the benefits of globalization. This event is a tangible manifestation of the support for NEPAD that the IMF, the African Development Bank, the World Bank, and other Joint Africa Institute sponsors have all demonstrated.

The question remains, however, what exactly is NEPAD? What are its goals? Where do we stand in regard to NEPAD's development?

NEPAD reflects a new approach, based on a long-term view of Africa's development process, guided by the principle of ownership of economic policies by the African people. NEPAD represents a quest for a new type of partnership between Africa and the international community, and in particular, a commitment to the mutual design and implementation of a set of priorities identified by African policymakers.

The objectives of NEPAD are in step with the established international development objectives:

- Over the next 15 years, achieve average GDP growth of over 7 percent.
- By 2015, reduce by half the percentage of people living in extreme poverty.
- By 2015, enroll all children old enough to attend primary school.
- By 2005, move toward gender equality and remove gender disparities in elementary- and secondary-school enrollment.

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- By 2015, reduce infant and post-infant mortality rates by two-thirds.
- By 2015, provide access to reproductive health services for all who need them.
- By 2005, implement regional strategies for sustainable development compatible with the preservation—by 2015—of ecosystems and ecological resources.

NEPAD's operations reflect an action program that identifies activities to be undertaken in the short, medium, and long terms. These actions fall into two major categories. The first involves satisfying the essential requirements for sustainable development through efforts to promote peace and security, democracy and good governance—including economic and corporate governance—and human rights. The second entails taking a regional and continent-wide approach to strengthening Africa's capacities, focusing on the following sectoral priorities: infrastructures in all sectors, including new information technologies; human resources (education, health, and loss of intellectual capital); agriculture; environment; culture; and science and technology.

Within each sector, the aim is to bridge rapidly the gap between Africa and the developed countries in order to put the economies of Africa on an equal footing with those of their competitors, so that they can compete internationally and participate meaningfully in the globalization process.

Five key regions have been identified: West Africa, North Africa, Central Africa, East Africa, and Southern Africa. NEPAD's assessments of needs (in physical and in value terms) are still approximate. NEPAD is exploring two approaches to financing its action program:

- First, mobilize more of Africa's internal resources while simultaneously attracting foreign private capital. Naturally, measures involving private capital flows should be viewed from a long-term perspective. In the short and medium terms, efforts will also focus on official development assistance (ODA) and on debt, with the aim of obtaining debt relief on a scale that exceeds current levels.
- Second, expand the access of African products to international markets.

The operative principle for the assessment of financial needs is to carry out that assessment at the national level, then at the subregional level, and lastly at the continent-wide level.

With respect to the institutional framework for NEPAD, a committee of heads of state has been created to oversee the implementation of this new initiative. This committee is composed of the five founding heads of state of NEPAD—namely Presidents Thabo Mbeki, Abdelaziz Boutefika, Olusegun Obasanjo, Hosny Mubarak, and myself—as well as

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10 other heads of state (two in each region). These membership arrangements are particularly important since they attest to the commitment of Africa's highest authorities and ensure that NEPAD will have substantial political and institutional backing.

Since the adoption of the New Africa Initiative at the summit of heads of state of the Organization of African Unity, in Lusaka, Zambia, in July 2001, major outreach efforts have taken place. We have worked to build the support of ordinary people and economic agents in Africa and elsewhere, as well as the region's international development partners, and to rally them around this new approach to development in Africa. The original impetus came from the countries themselves, both within Africa, on the occasion of the summits of heads of state and government, and outside Africa, at the summits of the Group of Eight leaders and other bilateral meetings. A second milestone in launching the New Africa Initiative was the Dakar conference of April 15–17, 2002. The theme of this conference, which brought together African heads of state and representatives of the African and international private sectors, was the role of the private sector in NEPAD financing.

A further meeting of public and private sector representatives is scheduled for January 2003 in Dakar. This Dakar meeting will highlight the arrival of a third type of partner. This is the financial sector—specifically, one of its most influential branches, namely the multilateral international financing institutions that play a major catalytic role within the international financial community.

The African heads of state who are members of the NEPAD implementation committee met in Abuja, Nigeria, on November 2, 2002, to discuss a number of issues, including the establishment of an African mechanism to assess and monitor progress in achieving compliance with generally accepted standards for political, economic, and corporate governance. This meeting and the decisions it adopted plainly reflect the African nations' determination to move from the NEPAD design and outreach phase to the action phase.

This will provide the necessary background for your work in this seminar. In recent years, with socioeconomic problems worsening in various regions of the world—evidenced in particular by the spread of poverty—and with the least advanced countries falling farther and farther behind, international conferences under United Nations auspices have been organized to urge the international community to address these issues. These meetings have included the Brussels Conference on Least Developed Countries, the Monterrey Conference on Financing for Development, and the Johannesburg World Summit on Sustainable Development. Participants at these conferences discussed a number of topics that are also featured in

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the agenda for this seminar, although a closer look reveals that they confined themselves to general recommendations.

The seminar should therefore focus on identifying and preparing strategic recommendations tailored to the specific conditions in Africa. Having glanced at the agenda for these meetings, I can say that with our distinguished guests—and the wealth of expertise they bring to the task—we can expect an exceptionally high standard in the discussions and assessments of the challenges and operational issues connected with the implementation of NEPAD.

In closing, I would like to offer some comments on a number of matters.

Development financing. On this topic, I would like to refer to the theme of a session entitled "What Can the IMF Do?" It has long been my conviction that the international financial community must take an innovative approach to development financing if it is to address what I call the credit/aid double bind. With particular reference to the financing of NEPAD, Africa is proposing to its development partners that the traditional sources of public and private capital flows be augmented by issuing treasury securities by development partners as well as special drawing rights specifically intended for Africa. I have been advocating such a policy for nearly 30 years, and it is as timely and relevant as ever.

The question of African debt. Solutions have been proposed repeatedly, without much success. Accordingly, I have proposed to my fellow heads of state that a continent-wide seminar be held in Dakar in 2003. The purpose of this seminar will be to analyze and gain an understanding of the dynamics of African debt, using a "debt imaging" diagnostic methodology. I consider this a prerequisite for designing viable strategies for emerging from the debt dilemma. The development partners—and especially the multilateral international institutions—will be invited to these meetings to share their experience with African experts.

Development of human resources, and capacity building in particular. One of NEPAD's specific objectives is to reverse the trend toward the flight of intellectual capital from Africa, especially the loss of high-level expertise. In this context, our partners and we should consider appropriate incentives to promote the involvement of these expatriate African experts in technical assistance programs. We need to find ways to encourage them to return home for good.

And last but not least, public-private partnerships. In the new globalized environment, businesses are essentially in competition with one another. However, experience has shown that governments can provide significant assistance to businesses through a variety of channels open only to the state. Governments can build a strong legal, fiscal, and regulatory environment. They can engage in economic diplomacy, particularly in

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international negotiations. They can establish, maintain, and develop a technical and scientific critical mass. They can create an efficient system for strategic, forward-looking economic and social analysis. Consequently, Africa should not overlook the trend toward the reorganization of public-sector–private-sector relationships on new bases, as already observed in the industrial countries and in a number of emerging economies (such as Malaysia, Mauritius, and Tunisia).

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4

The New Partnership for Africa's Development: Opportunities and Challenges

NORBERT FUNKE AND SALEH M. NSOULI[1]

The New Partnership for Africa's Development (NEPAD), adopted in 2001, is a pledge by African leaders to eliminate poverty and to achieve a sustainable path of growth and development on the continent. Although previous continent-wide initiatives have not led to the desired results, there is hope that this outcome will be different. This expectation is based on NEPAD's new building blocks, which are critical for successful reform. New is the extent of African ownership and leadership of the development agenda, anchored in the recognition that African countries themselves have the primary responsibility for improving economic and social conditions on the continent. Also new is the wide acceptance of the proposition that good governance plays a key role in fostering growth and reducing poverty. Another new element is the extent of international appreciation and support for this initiative.

To achieve its objectives, NEPAD stresses four core elements:

- It acknowledges that peace, security, democracy, and good governance are preconditions for investment and growth and the reduction of poverty.

[1]We thank Masood Ahmed, Abdoulaye Bio-Tchané, Evangelos A. Calamitsis, Roland Daumont, Andrew Feltenstein, Joshua Greene, Samir Jahjah, Naheed Kirmani, Françoise Le Gall, Damian Ondo Mañe, and Ismaila Usman for their comments on this paper.

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- It aims at promoting private sector development and regional and global economic integration.
- It builds on action plans to develop the key pro-poor sectors of health care, education, infrastructure, and agriculture.
- It underscores the importance of more productive partnerships between Africa and its bilateral, multilateral, and private sector development partners.

This chapter reviews the major issues involved in achieving the objectives of NEPAD, with a focus on those aspects that fall within the core mandate of the International Monetary Fund (IMF). The first section provides a backdrop on the NEPAD initiative by reviewing Africa's economic performance during the past decade. The second provides an analysis of NEPAD. It evaluates the overall plan, looks at crucial factors for accelerating growth and reducing poverty, and assesses key NEPAD initiatives to achieve these goals, notably the consolidation of macroeconomic stability, the promotion of trade, the attraction of capital flows, and the reform of institutions. The third section discusses implementation issues and challenges and assesses the opportunities and the risks confronting NEPAD. The fourth discusses the steps that African countries need to take to achieve NEPAD's objectives. The fifth section reviews how the international community can support NEPAD. The final section draws some broad policy conclusions.

The Setting: Africa's Performance During the Past Decade

Macroeconomic Performance

Despite recent signs of progress, Africa's overall economic performance has been disappointing. Since the early 1980s, real GDP growth has averaged only 2.5 percent a year, and real GDP per capita has remained virtually unchanged (Figure 4.1 and Table 4.1).[2] Thus, extreme poverty is still widespread, particularly in sub-Saharan Africa. Based on the World Bank Atlas method, which uses three-year averages of exchange rates, in 2000 GNP per capita amounted to only $470 in sub-Saharan Africa, compared with an average of almost $27,700 in high-income countries (World Bank, 2002a).

Weak domestic policies have contributed to this lackluster performance, but factors beyond the control of African countries, such as negative terms-of-trade shocks, have also affected performance (see also Easterly and Levine, 1998). During the 1980s and the first half of the 1990s, macroeconomic policies in Africa were often unsatisfactory, in-

[2]See, for example, Berthélemy and Söderling (2002).

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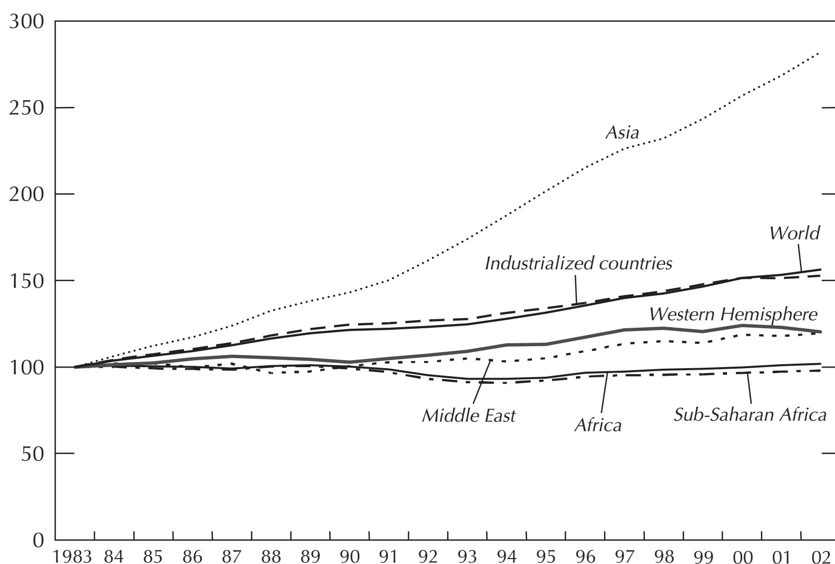
Figure 4.1. Real GDP Per Capita Across Regions
(1983 = 100)



Source: IMF, *World Economic Outlook* database.

Table 4.1. Real GDP Growth Trends Across Regions
(In percent a year)

	Real GDP Growth			Growth of Real GDP Per Capita		
Region	1980s[1]	1990s	2000–2002[2]	1980s[1]	1990s	2000–2002[2]
Africa	2.6	2.2	3.3	0.1	–0.2	0.6
Sub-Saharan Africa	2.5	2.1	3.2	0.1	–0.5	0.4
(excl. Nigeria and South Africa)	2.7	2.3	4.2	0.0	–0.4	1.3
Asia	6.9	7.4	5.8	5.5	5.8	4.8
Middle East	2.2	3.8	2.6	–0.4	1.6	0.3
Western Hemisphere	2.1	3.0	0.0	0.7	1.4	–1.5
World	3.4	3.1	2.5	3.0	2.1	1.6

Source: IMF, *World Economic Outlook* database.
[1]1983–89.
[2]Data for 2002 are projections.

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stitutions deteriorated, and governance was weak. In addition, a number of countries faced periods of adverse external conditions or had to cope with internal conflicts. Better macroeconomic management, market liberalization, and progress in private sector development improved growth appreciably in the mid-1990s. However, this short period of higher growth rates was soon followed by a moderation in economic performance.

The measures of average performance cited above hide important differences across countries. This becomes evident when the experience of the best-performing African countries is compared with that of the weakest-performing countries. For illustrative purposes we refer to the top-five growth performers between 1990 and 2001 as "high-growth countries." This group comprises Botswana, Mauritius, Mozambique, Uganda, and Tunisia.[3] The bottom-five growth performers, referred to as "low-growth countries," comprise the Democratic Republic of Congo, Djibouti, Sierra Leone, Zambia, and Zimbabwe.[4]

Figure 4.2 shows the development of selected macroeconomic indicators for Africa as a whole, for the high-growth countries, and for the low-growth countries. For the last two groups, unweighted averages are used. Without asserting any direct causality, the following observations can be made:

- The low-growth countries had substantial financial disequilibria both domestically (high inflation, large budget deficits) and externally (large current account deficits), as well as low saving and investment rates.
- By contrast, the high-growth countries had lower average inflation, smaller budget deficits, smaller current account deficits, and higher saving and investment rates. In these countries, investment reached some 25–30 percent of GDP, whereas in the low-growth countries investment rates were approximately 10–15 percent of GDP.
- High-growth countries tended to be substantially more open than the low-growth countries and more open than the average African country.

This analysis suggests that macroeconomic policy weaknesses are indeed an important contributor to weak growth performance in Africa.

[3]Equatorial Guinea is not included in the group of high-growth countries because temporary double-digit growth rates in that country reflected mostly special factors, notably a spectacular oil-induced growth.

[4]Qualitatively similar results emerge when the groups of high-growth countries and low-growth countries are enlarged, for example to include the top and the bottom quintile of the distribution, respectively (see, for example, IMF, 1999).

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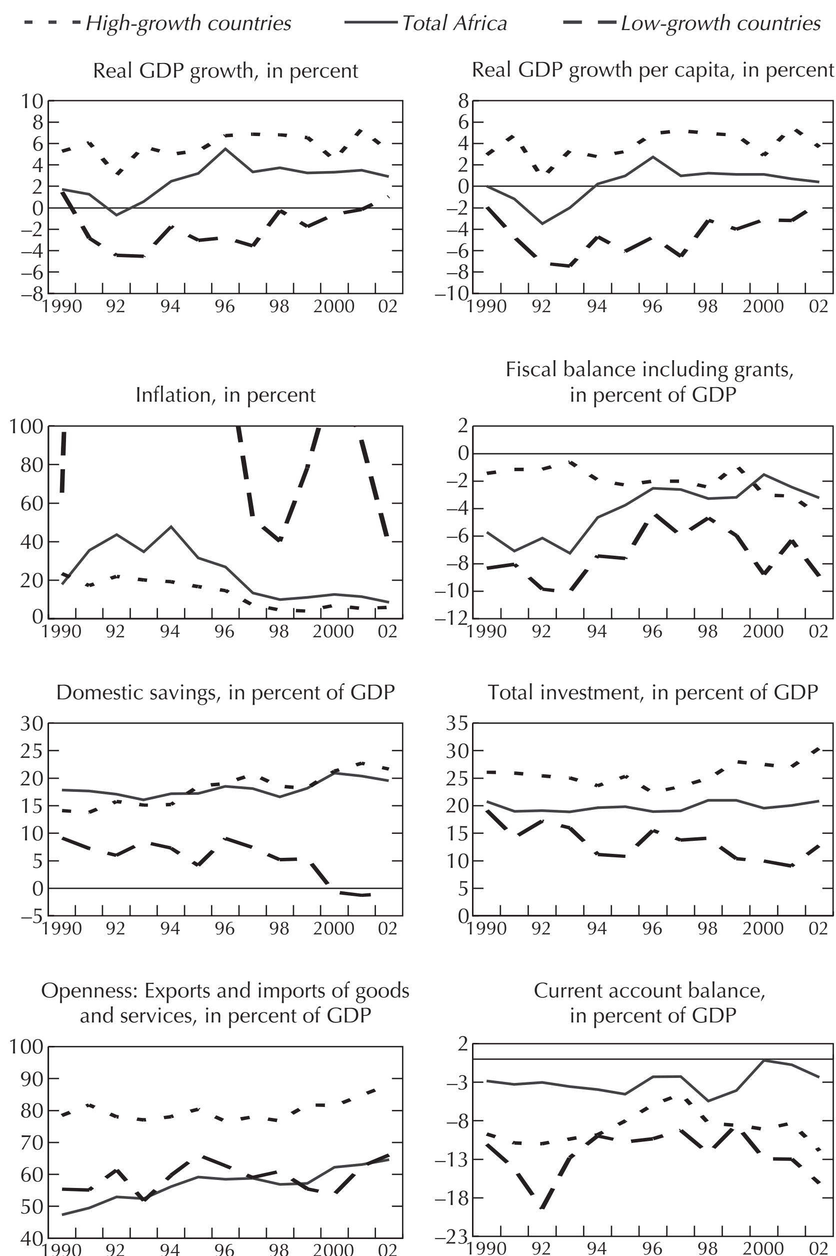
Figure 4.2. Selected Economic Indicators in High- and Low-Growth African Countries[1]



Source: IMF.

[1]Forecasts for 2002. Openness for low-growth countries excludes Djibouti.

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Reflecting the inadequate growth performance, social conditions in Africa remain among the poorest in the world. In particular, in sub-Saharan Africa almost half of the population still lives on less than $1 a day. Moreover, although some progress has been made since the early 1970s, sub-Saharan Africa lags behind most other regions in terms of literacy rates, school enrollment, and health conditions (Table 4.2). Much more worrisome, HIV/AIDS has assumed alarming proportions in many African countries, posing a major threat to economic growth and development.

Structural Indicators

Africa made major strides in implementing structural reforms during the late 1980s and in the 1990s, with many countries moving from heavily controlled and state-dominated economies to market-oriented economies. In general, price controls have been removed, state control of marketing arrangements has been liberalized, quantitative trade restrictions have been nearly abolished, public-enterprise reform and privatization have been widely pursued, exchange restrictions on current account transactions have been virtually eliminated, and labor markets have been reformed. Yet in spite of the broad progress made, a number of African countries need to continue and deepen their structural reforms.

Although a number of structural bottlenecks have been eased, the quality of governance, institutions, and public services has also emerged as a critical factor affecting growth. Table 4.3 presents several indicators of governance and institutions across regions. Measures of government stability, democratic accountability, and ethnic tensions give some indication of a government's ability to carry out reform programs. Bureaucratic quality, law and order, and the degree of corruption are three indicators that capture the quality and strength of institutions. The investment profile includes such factors as risks to operations, taxation, and repatriation.

African countries have still not reached the levels of other regions in terms of governance and quality of institutions, although more countries in Africa espouse democracy and hold fair elections than ever before, and many countries have improved their governance. Table 4.3 shows that the fastest-growing African countries are better governed and have a better institutional environment than the average for the region. But even they have not yet achieved the same levels as the newly industrialized economies in Asia. Conversely, indicators for the low-growth African countries are generally lower than the averages for Africa and substantially lower than the indicators for the high-growth countries. These findings

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Table 4.2. Selected Social Indicators in Low- and Middle-Income World Regions

(In percent except where stated otherwise)

Region	Share of Population Living on Less Than $1 a Day		HIV Prevalence[2]	Adult Illiteracy Rate		Life Expectancy at Birth (Years)		Infant Mortality Rate (per 1,000)		Primary School Enrollment[3]		Secondary School Enrollment[3]	
	1990	1998[1]	1999	1970	2000	1970	2000	1970	2000	1970	1998	1970	1998
East Asia and Pacific	27.6	14.7	0.22	44	14	59	69	79	35	90	107	24	62
Eastern Europe and Central Asia	1.6	3.7	0.18	7	3	n.a.	69	n.a.	20	n.a.	n.a.	n.a.	n.a.
Latin America and Caribbean	16.8	12.1	0.58	26	12	61	70	84	29	107	130	28	75
Middle East and North Africa	2.4	2.1	0.03	70	35	52	68	134	43	70	97	24	60
South Asia	44.0	40.0	0.56	68	45	49	62	138	73	71	101	23	48
Sub-Saharan Africa	47.7	48.1	8.38	72	39	44	47	138	91	51	78	6	26[4]
World	29.0	23.4	1.19	n.a.	25	59	66	98	54	85	104	34	65

Source: World Bank and World Development Indicators

[1]Data are estimates.

[2]Share of population aged 15–49 infected with HIV.

[3]As share of primary or secondary school-age population.

[4]As of 1996.

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Table 4.3. Indexes of Quality of Governance, Institutions, and Public Services in Selected Regions During the 1990s[1]

Region or Group	Government Stability	Democratic Accountability	Ethnic Tensions	Quality of Bureaucracy	Law and Order	Corruption	Investment Profile
Asian NIEs[2]	6.8	6.0	8.3	8.2	8.1	6.8	6.0
Asia	6.0	5.5	6.3	5.9	6.5	5.3	5.1
Western Hemisphere	5.7	6.1	7.4	4.1	5.3	4.9	5.3
Africa	5.5	4.4	5.3	3.8	4.8	4.5	4.6
Of which:							
High-growth countries[3]	6.4	4.5	6.6	4.3	5.8	5.5	5.4
Low-growth countries[4]	4.7	4.0	5.3	3.0	4.1	3.5	3.6
World	6.1	6.1	6.8	5.5	6.5	5.6	5.2

Source: *International Country Risk Guide*, published by Political Risk Services.

[1]Index from 0 to 10, with the higher score indicating a better quality. Data are averages for the 1990s. For all groupings, data are unweighted averages of economies for which information is available. Indicators have been rescaled.

[2]The newly emerging economies include Hong Kong SAR, Republic of Korea, Singapore, and Taiwan Province of China.

[3]Botswana, Mauritius, Mozambique, Uganda, and Tunisia.

[4]Democratic Republic of Congo, Djibouti, Sierra Leone, Zambia, and Zimbabwe.

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are consistent with those of a survey of 23 African countries conducted by the Harvard Institute for International Development (Sievers, 2001).

Analysis of NEPAD

Deeply concerned about inadequate economic growth and widespread poverty in their region and with the increasing marginalization of Africa in an interdependent world economy, African leaders resolved to undertake NEPAD. In the following sections, we analyze the nature of NEPAD and its key initiatives in the context of a simple analytical framework, set out in Table 4.4.

Table 4.4. The NEPAD: A Simple Framework for Analysis

Area	Policy Questions
Overall plan	• What is the NEPAD from an economic perspective—a Marshall Plan, a framework, an institution, or a blueprint? • What are its basic objectives? Are they coherent? • How ambitious are the reform objectives in terms of quantity and quality? • Are reform priorities well specified? • In what way does NEPAD differ from previous initiatives?
Analysis of selected initiatives	• What are the economic benefits of the initiative? • What should reform priorities be in light of recent developments in Africa? • Are there any specific lessons from recent reform experiences?
Risks	• What are the opportunities and risks associated with NEPAD? • What needs to be done to minimize risks?
What must African countries do to achieve results?	• How can public support be obtained and sustained? • How can authorities increase the credibility of NEPAD? • How can reform progress be measured? • What are the contingency provisions needed to address reform slippages or unforeseen shocks?
How can the international community support NEPAD?	• What should be the relation between NEPAD and other ongoing international initiatives? • How can cooperation between donors be improved? • Under what conditions will international support likely increase?

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Overall Plan

As originally intended and described by its architects, NEPAD represents a common vision and strategic framework for Africa's renewal (see Box 4.1). As such, it is neither a Marshall Plan, a regional institution, nor a "blueprint."

The press at times has interpreted NEPAD as a kind of "Marshall Plan for Africa" (see Herbert, 2002). Unlike the Marshall Plan, however, NEPAD is not foreign-led; it is an African-owned initiative. Its goal is not to reconstruct something that existed previously, but to reach a new and substantially higher level of development.

Box 4.1. The NEPAD: Its Origins, Objectives, and Structure

The New Partnership for Africa's Development is "a pledge by African leaders, based on a common vision and a firm shared conviction, that they have a pressing duty to eradicate poverty and to place their countries, both individually and collectively, on a path of sustainable growth and development, and at the same time to participate actively in the world economy and body politic" (NEPAD, 2001). Accordingly, the three main, interrelated long-term objectives of NEPAD are eradicating poverty, accelerating growth, and stopping the marginalization of Africa in the globalization process.

The NEPAD resulted ultimately from a merger of the Millennium Partnership for the African Recovery Program (MAP) and the OMEGA Plan. The MAP was a far-reaching plan that embraced many aspects of development, including conflict resolution, governance, investment, aid, and debt. The plan was initiated by Presidents Abdelaziz Bouteflika of Algeria, Thabo Mbeki of South Africa, and Olusegun Obasanjo of Nigeria. The OMEGA Plan, put forward by President Abdoulaye Wade of Senegal, focused on four priority sectors: agriculture, education, health, and infrastructure. The finalization of the merger between the MAP and the OMEGA Plan led to the New Africa Initiative (NAI)— approved by the Organization of African Unity Summit of Heads of State and Government, and later endorsed by the leaders of the Group of Eight countries—in July 2001. The Heads of State Implementation Committee (HSIC) finalized the policy framework in October 2001, and the NAI was renamed NEPAD.

The NEPAD is based on a number of principles, most importantly those of African ownership and leadership, broad participation by all sectors of society, domestic and international partnerships, and, more generally, on a commitment to the Millennium Development Goals. These goals include the following: to reduce the proportion of people living in extreme poverty (or on less than $1 a day) by half between 1990 and 2015; to enroll all children of school age in primary school by 2015; to move toward gender equality and remove gender dis-

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The NEPAD has also been compared to a regional institution (for example, Kanbur, 2001). However, a regional institution typically focuses on more narrowly defined goals and initiatives; it has dedicated resources; and it has mechanisms to enforce contracts. By contrast, NEPAD is broad-based and comprehensive; and as yet, it has little enforcement power.

Nor is NEPAD a blueprint for African development. Implementation details are still being developed and will largely be formulated in the context of the national development strategies of individual African countries.

The opening paragraph of the NEPAD framework sets out three interrelated objectives for African countries—eradicating poverty, achieving

parities in elementary and secondary enrollment by 2005; to reduce infant and child mortality ratios by two-thirds between 1990 and 2015; to reduce maternal-mortality ratios by three-quarters between 1990 and 2015; to provide access for all who need reproductive health services by 2015; and to implement national strategies for sustainable development by 2005 compatible with the preservation, by 2015, of the ecosystem and ecological resources. To help achieve these goals, the NEPAD calls for attaining and sustaining average growth of real GDP of above 7 percent a year for the next 15 years.

To translate the goals of NEPAD into action, Section V of the October 2001 NEPAD document, entitled "Program of Action: The Strategy for Achieving Sustainable Development in the 21st Century," is central. The Program of Action is divided into three parts: it discusses the conditions for sustainable development, identifies sectoral priorities, and looks at the mobilization of resources. In each of these three parts, major initiatives are laid out. These major initiatives fall under peace, security, democracy, and political, economic, and corporate governance; bridging the infrastructure gap, human resource development, agriculture, and environment; and capital flows and market access.

The highest authority of the NEPAD implementation process is the Heads of State and Government Summit of the recently launched African Union (AU), formerly known as the Organization of African Unity. Below this is HSIC, which is composed of 20 members, four from each of the five African subregions. The HSIC reports to the AU summit on an annual basis. The personal representatives of NEPAD heads of state and of government of the five initiating members—South Africa, Algeria, Nigeria, Egypt, and Senegal—form a steering committee. The coordinating and liaison arm of the NEPAD Steering Committee is the Secretariat of NEPAD, which is based in Johannesburg, South Africa. Following instructions of the Steering Committee, the Secretariat is in charge of coordinating projects and processes that the HSIC has identified as priorities. The NEPAD Secretariat is an interim arrangement, pending the eventual full integration of NEPAD into the African Union's structures and processes

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sustainable growth and development, and participating actively in the world economy (NEPAD, 2001). But this clarity gets somewhat blurred in some other parts of the framework document. For example, given that poverty reduction is an overarching objective, it is surprising that poverty reduction is also listed as one of several aspects under the human resource development initiative. Also, each NEPAD initiative has several objectives, which appear at times as final goals in themselves. For example, under the market access initiative, one of the stated objectives is "to develop Africa into a net exporter of agricultural products" (NEPAD, 2001, p. 40). Although this may help support Africa's development, it cannot be seen as a goal in itself.

The NEPAD addresses a fairly coherent range of issues. If poverty reduction is to be seen as the overall objective, a necessary but not sufficient condition for reducing poverty is increasing growth. The various NEPAD initiatives in the Program of Action focus on particular aspects of reforms that will help to increase growth or to improve the social environment. Therefore, all NEPAD initiatives should be viewed and evaluated in light of their importance and contribution to achieving the main objective of reducing poverty along with enhancing growth.

The objectives of NEPAD are very ambitious. In particular, it will require tremendous effort for most African countries to achieve and sustain the targeted growth rate of real GDP of 7 percent a year that is needed to reduce by half the population living in extreme poverty by 2015. In this regard, it should be noted that growth performance in recent years has been moderate, budgetary pressures have persisted, and the external environment has been unfavorable. In addition, the number and diversity of NEPAD's initiatives suggest that NEPAD will inevitably face implementation constraints. Although a better-coordinated and more efficient use of resources may lessen these constraints, the situation calls for a clear prioritization of initiatives.

The NEPAD framework document implicitly and explicitly proposes some prioritization (see Kanbur, 2001). It acknowledges that the preconditions for sustainable development are conflict prevention, democracy, and good governance; thus high priority must be given to these areas. At the same time, the framework document identifies areas that should be fast-tracked, namely, communicable diseases (especially HIV/AIDS, malaria, and tuberculosis); information and communication technology; debt reduction; and market access (NEPAD, 2001, p. 54). In addition, the recent progress report to the HSIC further identifies top-priority actions, such as the implementation of the African Peer Review Mechanism (APRM) and the integration of NEPAD's principles into national development goals (NEPAD, 2002d). Useful governing princi-

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ples for further prioritization may be the likely impact of an initiative on the ultimate objective of poverty reduction, the time needed to achieve positive results, and, more generally, the lessons drawn from the timing and sequencing literature (see Feltenstein and Nsouli, 2001; and Nsouli, Rached, and Funke, 2002). Actions that will have a rapid and direct impact on poverty reduction should be implemented first. Also, sequencing considerations suggest that institutional reforms and, in particular, ensuring the rule of law need to be granted high priority.

In contrast with previous initiatives, NEPAD places major emphasis on African ownership, leadership, and accountability. This is best expressed in the concluding section of the framework document, which notes that "Africa recognizes that it holds the key to its own development" (NEPAD, 2001, p. 57). The APRM, which is a voluntary monitoring instrument involving member states of the African Union, is seen as an essential feature of this new sense of ownership and accountability. Its objective is to assess whether participating countries are adhering to the political and economic governance values, codes, and standards contained in the Declaration on Democracy, Political, Economic and Corporate Governance (see NEPAD, 2002a and 2002c; Cilliers, 2002). The review process envisaged under the APRM will lead to the preparation of a report by the evaluating team. This report will then be considered by the heads of state and of government of the participating member countries, and ultimately made public. Well implemented and enforced, the APRM should help promote the adoption of policies, standards, and practices that foster the goals of NEPAD.

Major Initiatives for Poverty Reduction and Sustainable Development

As indicated above, NEPAD gives high priority to conflict prevention, democracy, and good political governance as essential ingredients for Africa's renewal. Indeed, given Africa's past and even current experience, there is no doubt that the achievement of substantial poverty reduction and sustainable development will depend importantly on ensuring peace, security, human rights, and good governance throughout the continent.[5] Although these issues are not discussed further here, they are considered critical elements of Africa's development agenda. The following sections deal with other important issues and initiatives envisaged in the NEPAD document.

[5]For a comprehensive analysis of poverty reduction strategies, see World Bank (2000).

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Consolidating Macroeconomic Stability

In light of the conditions prevailing in most, if not all, African countries, NEPAD recognizes the need for consolidating macroeconomic stability. Macroeconomic stability is not only a one-time policy concern. It requires constant efforts to preserve and reinforce past progress. Countries that have already achieved a stable macroeconomic environment with single-digit rates of inflation must ensure that macroeconomic policies be geared toward maintaining this record.

A low-inflation environment is an important basis for future growth and for reducing poverty. For developing countries, Khan and Senhadji (2001) have shown that inflation rates above 7–11 percent a year are harmful for growth. High inflation tends to hurt the poor in particular, essentially because most of their transactions use financial assets that are not protected from erosion by inflation (Dollar and Kraay, 2001a). This suggests that countries that have not yet realized low inflation and a stable inflationary environment need to give high priority to achieving macroeconomic stability. This clearly holds for countries with very high rates of annual inflation of around 100 percent, such as Angola and Zimbabwe, but also for countries with lower but still double-digit rates of inflation, such as the Democratic Republic of Congo, Ghana, Madagascar, Nigeria, and Zambia.

Fiscal policy will have a particularly important role to play in the consolidation of macroeconomic stability. While ensuring financial stability, sound fiscal policy could also help promote growth and the reduction of poverty. Using a sample of 39 low-income countries, Gupta and others (2002) provide evidence that fiscal consolidation supports growth, in both the long and the short term. Results for the 1990–2000 period suggest that a reduction of 1 percentage point in the ratio of the budget deficit to GDP may lead to an increase in annual growth per capita of ¼ to ½ percentage point. This relates in particular to countries that have not yet achieved macroeconomic stability. The reduction of budget deficits also needs to be accompanied by a review and possibly a restructuring of public expenditure toward growth-promoting and pro-poor outlays. Baquir (2002) shows that social sector spending tends to increase with democratization.

A reallocation of public expenditure and improvements in public expenditure management are two important ingredients for a pro-poor strategy in the fiscal domain. Estimates from Baldacci, Guin-Siu, and de Mello (2002) suggest that an increase in education spending by one-third may be sufficient to achieve the millennium goal of universal primary education. In an empirical study of 65 IMF-supported country programs, Gupta and others (2000) show that increases in certain types

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of expenditure, such as spending on basic education and health services, are particularly beneficial for the poor and essential for poverty reduction. At the same time, public expenditure management needs to be strengthened to ensure that poverty-related spending is effectively delivered and monitored. A preliminary assessment of 25 heavily indebted poor countries (HIPCs), including 20 from Africa, showed that most of these countries needed substantial upgrading in their capacity to track and report on pro-poor spending (IMF and World Bank, 2002). A comprehensive expenditure review may be an important first step toward developing a coherent medium-term expenditure framework. Involvement of key stakeholders may increase local analytical capacity. For example, a recent public expenditure review in Zambia, with the involvement of key stakeholders and external technical support, has provided a good basis for strengthening public expenditure management (IMF and World Bank, 2002). More generally, for the short term, experience has shown that priorities should include measures such as broadened coverage of government expenditure, improvements in classification systems, the introduction of functionally based in-year reporting across ministries, and the piloting of integrated financial management systems. In the medium term, the overall framework of budget formulation, execution, reporting, and auditing needs to be reviewed and changed where needed.

Promoting Trade and Regional Economic Integration

The NEPAD program of action places great weight on promoting trade and, in parallel, ensuring market access. As numerous studies have shown (for example, Dollar, 1992; and Sharer and others, 1998), open economies promote a more efficient use of resources and faster growth. In a selected survey of cross-country regressions, case studies, and firm- and industry-level analyses, Berg and Krueger (2002) review the evidence for a relationship between openness and levels of income and between changes in openness and changes in GDP per capita. A fundamental finding is that an increase in trade volumes tends to lead to higher growth rates. Using firm-level panel data from three sub-Saharan African economies, Mengistae and Pattillo (2002) provide evidence that higher exports can lead to positive productivity effects through learning by exporting.

Cross-country studies and studies from country-specific liberalization periods suggest that the benefits of trade liberalization accruing to the poor are, on average, roughly equal to the benefits accruing to an average person (see also Dollar and Kraay, 2001a and 2001b; Srinivasan and Bhagwati, 2002). The benefits for the poor may even be more important

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if trade liberalization is accompanied by an increase in the relative wages of low-skilled labor and if liberalization of the agricultural sector results in higher rural incomes.[6]

Despite the important progress made in trade reform and trade integration in Africa since the early 1990s, the above considerations suggest that Africa's potential gains from increasing trade and diversifying exports are still very substantial (Ndukwe, 2004). Trade reform in the early 1990s eliminated most nontariff barriers and lowered peak tariff rates to a range of 20–30 percent. However, in many cases reforms have not yet been sufficient to support faster growth in income per capita. Africa's world export market share has continued to decline (from 3.9 percent in 1970 to 1.9 percent in 2001). Rodrik (1999b) emphasizes that more openness may be expected to lead to faster growth only if it is complemented by well-functioning institutions and sound domestic policies.

Sequencing considerations suggest that, in the next round of reforms, high priority needs to be given to dismantling the remaining nontariff barriers to trade, further simplifying and reducing existing tariff rates and structures, limiting exemptions, and improving customs administration. As emphasized in NEPAD, it is also important to foster export diversification in order to limit vulnerability to terms-of-trade shocks. At the same time, exchange rates must be maintained at competitive levels.

Regional economic integration has been progressing only gradually.[7] An acceleration of such integration would also help to promote trade. The authorities of the West African Economic and Monetary Union (WAEMU) have made progress on the integration front with the entry into effect of the customs union in 2000.[8] The Central African Economic and Monetary Community (CAEMC) has initiated a number of projects aimed at establishing a single market in the region.[9] To fully achieve this goal, further progress is needed in the areas of trade liberalization, harmonization of taxation, and the facilitation of movement of persons. Although the Southern African Development Community has started to phase in a free-trade area, this will be only fully realized

[6]For a skeptical view of the existing empirical analyses, see Rodriguez and Rodrik (1999). On the political economy aspects of trade protection and reform, see Krueger (1996) and Lal and Snape (2001).

[7]For a wider analysis of trade reform and regional integration, see Iqbal and Khan (1998).

[8]The members of the WAEMU are Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal, and Togo.

[9]The members of the CAEMC are Cameroon, the Central African Republic, Chad, the Republic of Congo, Equatorial Guinea, and Gabon.

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by 2008, according to existing plans. Integration objectives will also be facilitated by the convergence of macroeconomic policies.

Attracting Capital Flows

To achieve the targeted economic growth rate of 7 percent and meet the Millennium Development Goals (MDGs), the NEPAD framework document indicates that Africa will need to fill an annual resource gap of $64 billion (equivalent to 12 percent of GDP). Although this will require increasing domestic saving, the bulk of the needed resources will have to be obtained from abroad. Thus, NEPAD emphasizes the importance of attracting capital flows.

Foreign capital flows can have positive effects on domestic investment, technology spillovers, domestic financial development, and the productivity of investment (Fuchs-Schündeln and Funke, 2001). However, for such effects to occur, financial markets must be efficient, and foreign funds must be used in a way that supports the development process. Trying to attract long-term capital flows, in particular foreign direct investment (FDI), is an essential first step in mobilizing private foreign financial resources. In contrast, there is more debate over the benefits and risks associated with portfolio flows, in particular short-term capital flows. There is concern that the higher volatility of short-term capital flows may increase countries' vulnerability to crises.[10]

Foreign direct investment has the potential to play a pivotal role in Africa's development. However, although the stock of FDI in Africa increased from around $33 billion in 1980 to almost $150 billion in 2000, Africa's share of global FDI has continued to fall (Table 4.5).

Table 4.5. Inward Foreign Direct Investment Stock by Host Region as a Share of Global Stock

(In percent)

Region or Group	1980	1985	1990	1995	2000
Industrial countries	56.0	58.4	71.6	68.0	64.9
Developing countries	44.0	41.6	28.2	30.7	33.0
Africa	4.6	3.5	2.6	2.6	2.4
Latin America and the Caribbean	7.2	8.2	6.0	6.7	9.9
Asia and the Pacific	32.2	29.9	19.6	21.4	20.8
Central and Eastern Europe		0.1	0.1	1.3	2.1

Source: *World Investment Report.*

[10]Edwards (2001), Eichengreen and others (1998, 1999), and Ishii and Habermeier (2002), among others, analyze policy issues related to capital account liberalization.

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Analyzing empirically the determinants of FDI to developing countries, Asiedu (2002) shows that openness to trade promotes FDI, but that higher returns on investments appear to have no significant positive impact on FDI in sub-Saharan Africa. This may be because Africa's small and vulnerable economies are considered to present high risk in the eyes of many international investors. In such cases, small increases in returns are not sufficient to compensate for the major risk factors, such as poor judicial and financial infrastructure, as well as widespread corruption. Burdensome regulation may also make investments more costly. At the same time, a "neighbor effect" may discourage FDI: even if one country is pursuing stable policies that are conducive to investment, neighboring countries may not. This may have a negative effect on investment in the whole region.

A closer analysis of country experiences may also help identify important factors in attracting FDI. Some non-oil-producing countries, such as Botswana, Lesotho, Mauritius, Mozambique, Namibia, Swaziland, and Uganda, have been relatively successful in attracting FDI (Basu and Srinivasan, 2002). Although the main reasons for this success differ from country to country, overall their positive experience points to the advantages of far-reaching macroeconomic and structural reforms, political stability, the availability of natural resources, and a policy environment conducive to investment, such as privatization of state assets and other host-country policies targeted toward attracting foreign investment.

Most African countries need to overcome the perception of high risk. Apart from macroeconomic stability, further improvements are essential in the institutional environment and the functioning of domestic financial markets. Asiedu (2004) argues that an absolute improvement in the investment climate may not be sufficient to attract a larger share of FDI in a globally competitive environment. For African countries, it is also important to achieve an improvement in the policy environment relative to that in their main competitors. Also essential to an improved investment climate will be the way in which the various NEPAD initiatives are implemented. Rigorous implementation of action plans would signal a clear change in policy and make policy reversal less likely in the eyes of international investors.

More generally, financial market access requires good management of market expectations. An analysis of risk ratings suggests that several years of good policy performance may be needed to change market perceptions. An active dialogue between the government and executives of domestic and international companies is essential. Investment advisory councils (IACs) are one vehicle to improve the investment environ-

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ment. The recently established IACs in Ghana, Senegal, and Tanzania are steps in this direction.

Fostering Good Governance and Institutional Reform

The foregoing discussion has highlighted that two interrelated key challenges are to implement reform successfully and to improve the quality of institutions. Two countries with identical endowments of capital and labor and identical production facilities may have different levels of income and wealth if their governance and institutions differ. The absence of good governance, the rule of law, and a sound institutional environment typically leads to rent seeking and widespread corruption (Abed and Gupta, 2002).

Governance refers to the manner in which authorities deal with their responsibilities (Wolf and Gürgen, 2000). Key questions are the following: Is the government effective? Are the authorities' decisions and policies transparent? Do the authorities follow internationally accepted standards and codes? Is the government accountable for its decisions? In the context of NEPAD, an explicit distinction is made between political and economic governance through two separate initiatives: the peace, security, democracy, and political governance initiative, and the economic and corporate governance initiative. By giving these two initiatives a prominent place in the section on "Conditions for Sustainable Development," NEPAD acknowledges the overriding importance of good governance for the achievement of its basic objectives (Sako, 2004).

Good governance is an important part of a sound institutional environment and is essential for success in many other reform areas. If institutions are weak, policies are also most likely to be weak (Goldsmith, 1998). In general, good governance and well-functioning institutions provide an enabling environment for private initiative and allow for a more efficient use of resources. Policy reforms in areas such as trade and capital flows will only bring about the full potential gains if the institutional framework is appropriate.

Empirical evidence confirms that institutions play a key role in economic performance (World Bank, 2002b). An index of institutional quality performs well in explaining growth differentials (see, for example, Rodrik, 1997). Hall and Jones (1997) confirm, in a study of 133 countries, that differences in social infrastructure account to a very large extent for differences in output per worker. Institutions that favor production over "diversion"—that is, the misuse of production—and some form of private ownership foster the accumulation of human and physical capital, eventu-

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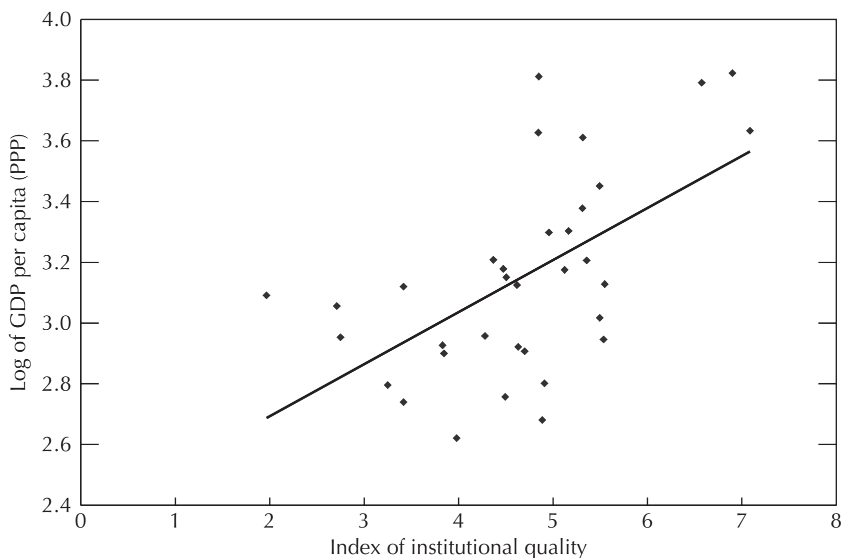
ally leading to higher total factor productivity and overall growth. A more recent analysis even provides some evidence that the quality of institutions is the most important determinant of income levels around the world (Rodrik, Subramanian, and Trebbi, 2002). Also, a simple correlation analysis shows that institutional quality and GDP per capita are very closely related in Africa (Figure 4.3).

The question is no longer whether institutions matter, but *which* institutions matter, and which institutional reforms have to be implemented when. Rodrik (1999a) distinguishes among five types of institutions: property rights, regulatory institutions, institutions for macroeconomic stabilization, institutions for social insurance, and institutions for conflict management. A clearly delineated system of property rights protects the assets of investors and the return on those assets and supports contract enforcement. Regulatory institutions, such as bank regulatory agencies, encourage competitive behavior, limit anticompetitive practices, limit the worst cases of fraud, and more generally promote sound economic development. Institutions for macroeconomic stabilization are those responsible for monetary and fiscal management and can help support economic development. For example, oil-stabilization funds fall into this category. Institutions for social insurance may take the form of transfer programs, such

Figure 4.3. GDP and Institutional Quality in Africa



Sources: World Bank; *International Country Risk Guide*; and IMF (2002c, p. 51).

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as institutions for the payment of unemployment benefits, or health- and pension-related institutions. Finally, institutions for conflict management include, for example, the rule of law and high-quality judiciary systems.

The distinctions among these five types of institutions suggest that reform priorities differ from country to country, depending on the development of the various types of institutions. In an initial stage of development, and to encourage private sector initiative, market-creating institutions may be most important. In countries where property rights are not clearly defined, highest priority needs to be given to this task. In addition, reliable institutions for conflict management are important to promote the domestic exchange of goods, to foster international trade, and to attract international capital.

Issues and Challenges in Implementation

Moving from a Basic Framework to an Operational Blueprint

As NEPAD represents a common vision and strategic framework for Africa's development, a key issue is how this framework will be effectively translated into action. To a very large extent, the move from a basic framework to an operational blueprint will depend on the resolve of, and the steps to be taken by, each African country. Every African country will have to design its own blueprint, consistent with NEPAD's goals, to accelerate growth and achieve the MDGs. Depending on each country's circumstances, this will involve setting more specific quantitative objectives, as well as pursuing consistent macroeconomic policies and structural reforms, enhancing capacity building for deeper integration into the global economy, embracing the APRM, and transforming partnerships with donors through mutual commitments and accountability.

Work on national development blueprints has already progressed substantially, as in recent years many African countries have prepared either interim or full-fledged Poverty Reduction Strategy Papers (PRSPs), which are focused on enhancing growth and reducing poverty. Because the PRSP approach is country-driven, participatory in nature, comprehensive, results-oriented, and based on a long-term perspective for poverty reduction, it shares many of NEPAD's fundamental principles. It is an important instrument for incorporating continent-wide priorities into national poverty reduction programs and attracting the needed support from Africa's development partners. However, both PRSPs and NEPAD are still works in progress. In this regard, it is important to avoid duplication of effort, which may lead to inefficiencies and conflicting signals.

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The lessons of a recent in-depth review of the PRSP process may be useful for those working to achieve NEPAD's objectives (IMF, 2002b; IMF and World Bank, 2002). The lessons learned suggest the need to:

- Be as specific as possible in setting targets, thus facilitating their monitoring and increasing transparency.
- Develop and promote action plans on the basis of alternative policy choices and social impact analyses of these choices.
- Improve public-expenditure management.
- Elaborate on the risks to policy implementation, including those related to external shocks and shortfalls in financing.
- Include contingency planning in the macroeconomic framework.
- Encourage and further broaden the systematic participation of stakeholders in the discussion, design, and implementation of the various initiatives.

Apart from the key role of individual countries in the implementation of NEPAD's framework, responsibility for carrying out some programs and projects has been given to designated institutions, notably the African Development Bank and the Economic Commission for Africa. Moreover, the regional economic communities (RECs), which are considered essential building blocks of Africa's economic integration, have also been called upon to play a leading role in the implementation of infrastructure projects at the subregional level (Banny, 2004). Accordingly, it is expected that the organization and capacities of the RECs will be strengthened, and their evolution more closely related to the development of the African Union.

Opportunities and Risks

The NEPAD involves many opportunities. First and foremost is the unique opportunity for African countries to demonstrate ownership and leadership in setting the development agenda and carrying it out. Recent international discussions (for example, Khan and Sharma, 2002) have stressed the importance of country ownership for the success of reform programs and strategies. The Africa-wide recognition of the need to accelerate the continent's economic development and the broad consensus among African leaders regarding development priorities constitute an important precondition for the ability of African countries to reduce the development gap.

The NEPAD also provides a unique opportunity to align development objectives across countries while acknowledging country-specific differences. There are likely to be benefits from closer cooperation among African countries toward achieving these goals. When countries move

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together, economies of scale and scope can facilitate the overall tasks, provided that new inefficiencies are avoided.

The NEPAD is also expected to facilitate cooperation with the international community. The development challenge to reduce poverty requires a comprehensive strategy based not only on the efforts of African countries themselves but also on increased international financial assistance. A common understanding of reform priorities and needed resources will facilitate the dialogue between the international community and Africa. The NEPAD may also put Africa in a better position to strengthen its voice in international gatherings, which may ultimately lead to an increase in the transfer of resources to Africa.

Notwithstanding these opportunities, NEPAD also involves two broad and interrelated categories of risk: political risk and implementation risk. Given NEPAD's diversity of objectives, political priorities may differ between countries and hinder the progress of various initiatives. Implementation risks may also stem from too-high expectations, unclear responsibilities, a lack of credibility, and resource constraints. Some observers may regard partial fulfillment of the objectives of NEPAD as failure. And failure of this initiative would most likely increase the hurdles to be faced by any future reform initiative.

Expectations may be too high on the implementation side because of the broad-based nature of NEPAD. Given its scope, it is almost inevitable that progress will vary among countries and among various reform areas. The challenge therefore remains to translate the broad objectives into well-specified and tractable goals. Attention needs to be given to setting realistic targets and time frames for individual initiatives that take into consideration country-specific circumstances and constraints.

Another potential problem relates to the roles and programs of existing regional institutions. The NEPAD foresees that certain projects and reforms will be implemented regionally, but the ideal regional approach may not correspond to existing institutions or regions. There is a risk that NEPAD will lead to varying reform initiatives across regional institutions. At the same time, it is important that NEPAD not develop into another layer of bureaucracy. Although the current size of NEPAD structures is small compared with their tasks, it will remain a challenge to find the right balance between the resources devoted to this initiative and the tasks it undertakes.

Despite its current support, NEPAD has to meet the challenge of maintaining credibility over time. To establish that credibility, it is important to demonstrate at least some progress early. However, it has to be recognized that in many cases it simply takes time to implement reforms. Given

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the scope of the reforms, administrative capacity in each of the participating countries will be tested and may determine the speed at which reforms can proceed in a given country. Therefore, initiatives cannot be implemented in an identical manner across the continent. In addition, in a difficult external environment, it may take longer than expected to achieve positive results.

Finally, the availability of adequate resources, particularly of external financing, will put a natural limit on the speed of implementation. The willingness of the international community to actively contribute to NEPAD will to a large extent depend on Africa's ability to cope with its challenges.

What Must African Countries Do to Achieve Results?

To be successful, African countries will need to ensure good governance in all of its aspects and to implement sound macroeconomic policies and structural reforms as discussed in this chapter (see also Calamitsis, 2001; and Basu, Calamitsis, and Ghura, 2000). At the same time, further prioritization of reform initiatives will be needed. Uncertainties about the time frame, the costs and benefits of the various reform elements, and available financial resources make it difficult to set priorities. Setting priorities will require a very good understanding of the critical reform needs and available resources in each country. Prioritization should be based on a clear identification of policy options and trade-offs. Political-economy considerations also suggest that the focus should be on measures that can lead quickly to positive and measurable results.

In some cases, initial reforms may be accompanied by temporary costs in terms of output and employment. Greater reform credibility would reduce the risk and the magnitude of these potential short-term costs. However, credibility is difficult to establish and easy to lose. It requires consistent policy performance and visible achievements over a sustained period. One way to gain credibility is to implement policies on the basis of broad-based discussions with the general public, interested parties, and the international community. This must be followed by a convincing track record, transparency, and accountability.

Although NEPAD explicitly foresees a wider public discussion, it has been acknowledged in several forums, including the Conference of African Ministers of Finance, Planning, and Economic Development in October 2002, that more needs to be done in this area (United Nations Economic Commission for Africa, 2002). Although awareness at the senior international level is high, public participation in Africa is still

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limited. Reform efforts need to be based on a more open dialogue between governments and domestic stakeholders. The active selling of reforms must become an integral part of the NEPAD framework. In this regard, the efforts under way to set up national and regional NEPAD communications centers are steps in the right direction.

The APRM can also serve as an important vehicle for enhancing credibility. However, as African leaders noted themselves (United Nations Economic Commission for Africa, 2002, p. 4), the APRM must be free from political interference, it must be conducted consistently using high standards, and countries must be willing to take corrective measures in light of the findings. Countries not willing to accede to the APRM or to follow the recommended measures will in one way or another be exposed to the downside risks of inaction. Although it was envisioned to start in 2003, the APRM will take time to organize and implement its review process.[11] A period of learning by doing may be required, and the first reviews may not look like subsequent ones. It will take time until all interested countries have been reviewed, and a few years until a second review can assess any improvements. Although potentially a forceful mechanism, short-term improvements as a result of the APRM are less likely. In the meantime, each country must improve its economic and governance environment, using as a basis the internationally accepted guidelines and codes of good practices endorsed by the African heads of state and of government at their meeting in Durban, South Africa, in July 2002.

For each initiative and for NEPAD as a whole, a clear follow-up mechanism must be in place. Any broad-based initiative such as NEPAD may encourage some countries to free-ride on their partner countries' achievements. To make action plans more credible and verifiable, detailed timetables must be set up. At the same time, it is necessary to develop indicators that facilitate the monitoring and control of implementation.

Although in many cases it may be easy to see whether a country has implemented the envisaged changes, such as a tariff reduction, it is more difficult to assess whether these changes have led to the desired outcome.[12] Therefore, two types of indicators may be needed. The first set of indicators should be closely linked to the required action, that is, to the instrument of economic policy to be used (Type 1 indicators). The second set should be closely linked to the desired outcome of the action (Type 2 indicators). Type 1 indicators would give a clear picture of

[11]The HSIC recently asked the NEPAD secretariat to develop criteria and indicators for measuring performance on political and economic governance.

[12]See also the discussion on conditionality by Khan and Sharma (2002).

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whether the authorities have pursued reforms as announced. Type 2 indicators would signal whether the implemented policies are leading to the desired results. It is essential that these indicators be as objective as possible and free of manipulation. For example, in the area of trade reform, Type 1 indicators could relate to the abolition of quantitative restrictions or the reduction of average tariff rates. Type 2 indicators could relate to openness, measured as trade volume as a percentage of GDP, or to real export growth.

The use of indicators, if widely published, would increase the transparency of policy actions and the accountability of the authorities. In particular, a comparison of Type 1 and Type 2 indicators would allow differentiation between government failure to implement reforms and any discrepancies in the relationship between actions and outcomes.

In some areas, progress at reform may be slower than anticipated, in part because of unforeseen shocks. To minimize the costs associated with reform slippage, contingency provisions are needed. These relate to specific actions that have to be taken if expected results are not realized or if unforeseen shocks occur. For example, in the case of an external shock, the appropriate response will depend on the likely nature of the shock—whether country-specific or global, whether arising from demand or supply, whether transitory or permanent—and on its size. To the extent that adequate contingency provisions are in place, the policy response to events that could adversely affect the reform efforts would be speeded up, thereby ensuring the achievement of the desired objectives.

How Can the International Community Support NEPAD?

The Group of Eight (G–8) and the international financial institutions (IFIs) have welcomed NEPAD and have expressed their commitment to establishing enhanced partnerships with African countries. However, the international community has also made clear that support will be focused on those countries whose actions and performance are in line with the objectives of NEPAD. Exceptions will be made only in the case of humanitarian need. In the G–8 Africa Action Plan, adopted at the G–8 summit in Canada in June 2002, the leading industrial countries pledged substantial assistance to promote peace and security in Africa, strengthen institutions and governance (including the APRM), and improve education and health (including combating HIV/AIDS). Moreover, they made commitments to give African products greater access to their markets, to implement debt relief under the enhanced HIPC initiative, and to provide more-effective official devel-

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opment assistance. The IFIs have also committed themselves to provide increased technical and financial assistance to support strong African reform programs.

African leaders have noted with satisfaction these expressions of support for NEPAD and the specific actions already taken by the international community. In particular, with regard to market access, they welcomed the Everything-but-Arms Initiative of the European Union and the African Growth and Opportunity Act (AGOA) of the United States as important steps in enhancing opportunities for African producers and exporters.[13] They also welcomed the G–8 commitment to further trade liberalization under the Doha Round of multilateral trade negotiations within the World Trade Organization. As to debt relief, they appreciated the commitment made by the G–8 to help ensure that the projected shortfall in the HIPC Trust Fund is fully financed. Last but not least, they welcomed donors' commitment to allocate more new aid to Africa.

However, significant differences remain in nuance as well as in substance between the views and expectations of Africans and those of the donor community. African leaders are asking their international partners to remove all further barriers to trade, particularly agricultural subsidies, tariff peaks, and nontariff barriers; to expand and speed up the relief provided under the enhanced HIPC initiative; and to increase development assistance to the initial target of 0.7 percent of the donor countries' GDP, as well as to reform the modalities for the provision of such assistance. Furthermore, African leaders are urging a partnership with the rest of the world based on mutual commitments and accountability.

In welcoming the consensus reached in recent international conferences to fight world poverty, and noting especially the challenges of NEPAD, the heads of the IMF and the World Bank have emphasized the importance of a two-pillar approach to Africa's renewal (see, for example, Köhler, 2002). First, African countries must take strong action to implement appropriate policies and reforms along the lines discussed above. Second, the international community must provide increased, more efficient, and more comprehensive support to help African countries accelerate their progress toward attaining the MDGs. Otherwise, on present trends, few African countries are likely to meet most of the desired goals.

Apart from its financial assistance to African countries, notably under the concessional Poverty Reduction and Growth Facility, the

[13]On the AGOA, see, for example, Mattoo, Roy, and Subramanian (2002).

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IMF has responded to the requirements of NEPAD by intensifying its support for capacity building in Africa.[14] Accordingly, the IMF recently opened an Africa Regional Technical Assistance Center (AFRITAC) in Dar es Salaam. This is the first of five such centers envisaged for the region. Through the AFRITACs, the IMF will help African countries build local capacity for economic and financial management. Working closely with the African Capacity Building Foundation, the African Development Bank, the World Bank, and bilateral donors, the IMF will provide capacity-building efforts in its core areas of expertise, including macroeconomic policy, fiscal affairs, financial sector policies, and macroeconomic statistics. At the same time, the IMF will continue to enhance the training activities of the IMF Institute, which provides substantial support to African countries.

The IMF is also helping African countries improve their institutional environment by fostering transparency and accountability. The IMF has done extensive work on internationally agreed standards and codes of good practice and, in conjunction with national authorities, has embarked on a series of Reports on the Observance of Standards and Codes (ROSCs). These reports focus on 11 areas, including information on monetary and fiscal transparency, corporate governance, banking supervision, and accounting. In autumn 2002, reports from 14 African countries were already published on the IMF Web site, with a majority of the reports focusing on fiscal transparency. The expertise gained through these assessments as well as the ROSCs themselves could usefully serve as inputs for the APRM.

Under the enhanced HIPC initiative, by September 2002 the IMF and the World Bank had approved debt-reduction packages for 22 African countries and 4 other low-income countries. For these 26 countries that have benefited from debt relief, debt service is expected to fall by half in relation to exports or GDP between 1988–99 and 2001–05; it is expected to decline from 24 percent to about 10 percent of government revenue by 2005. Thus, although debt relief is not a panacea, more resources will become available for economic and social development purposes.

Conclusion

Despite the progress made by an increasing number of African countries toward macroeconomic stability and reform since the mid-1990s,

[14]On capacity building, see, for example, Dessart and Ubogo (2001) and Bio-Tchané (2004).

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Africa's overall growth performance has remained inadequate, and poverty is still widespread, with almost half of the population living on less than $1 a day. Thus, the adoption of NEPAD has been timely and important, giving renewed impetus to efforts focused on accelerating growth, reducing poverty, and integrating Africa into the world economy, consistent with the MDGs.

The enthusiastic support of NEPAD by African leaders and the international community has been based on its far-reaching vision and objectives. However, NEPAD has not yet attracted the same degree of support among the wider African public. Although NEPAD is based on a number of previous initiatives, in some respects it is fundamentally new. New is the wide recognition on the part of African leaders that they themselves have primary responsibility for improving economic and social conditions in Africa. Also new is their acceptance that good governance is critical for the achievement of sustainable development. Thus, NEPAD provides a unique opportunity to demonstrate African ownership of and leadership in implementing the development agenda.

This chapter has emphasized that poverty reduction can be seen as the overarching objective of NEPAD. Increased growth is then a necessary but not a sufficient condition for tackling poverty. The various NEPAD initiatives are geared toward increasing growth or achieving a more satisfactory social and structural environment. But the challenges are enormous, and realizing the targeted average annual growth rate of real GDP of some 7 percent will require unprecedented efforts and sustained implementation of sound macroeconomic policies and structural and institutional reforms.

The analysis in this chapter has highlighted a number of risks and pointed to factors that the authorities will need to take into account in order to minimize these risks. In moving from vision to action, it remains essential to:

- Broaden and deepen discussions with the wider public, so that NEPAD can obtain the necessary attention from, and acceptance by, all stakeholders
- Use PRSPs or other nationally owned development strategies to translate NEPAD's framework into operational blueprints
- Avoid duplication of effort by making good use of existing national, regional, and international arrangements and institutions
- Pay continuous attention to the sequence and pace of policy implementation in order to ensure policy coherence
- Strengthen the monitoring of progress by making some goals operational, developing detailed timetables, and establishing indicators in all relevant areas

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- Prepare contingency plans so as to be able to react quickly to sudden or unexpected shocks
- Clarify the responsibilities of NEPAD structures, individual countries, and regional and designated global institutions in the implementation process
- Harmonize fully implementation of NEPAD with other ongoing projects.

Because implementation will, to a large degree, take place on a national basis, the success of NEPAD will depend primarily on the willingness and ability of individual countries to implement needed reforms. The APRM is potentially an important mechanism to promote good governance and best practice in policy implementation. Although it will take time to make this instrument fully operational, it will need to be carried out in an objective and constructive manner, free of political interference. Anticipating a future peer review, countries may be tempted to wait until a first thorough review is finished, but such an attitude would clearly delay progress of NEPAD. It can only be hoped that the anticipation of an upcoming review helps to speed up reform efforts.

Although Africa's own efforts will be critically important, there is no doubt that substantial international support will be needed to help Africa achieve, or come as close as possible to achieving, the MDGs. Thus, consistent with commitments already made in various international forums, the leading industrial countries need to open up their markets to African products, provide adequate debt relief, and increase as well as improve the delivery of official development assistance. More international support will also be essential for capacity building and strengthening institutions in Africa. In all of these areas, the IMF, the World Bank, the World Trade Organization, and the UN system as a whole will also have important roles to play. But such support will not be forthcoming—or it will be much less than needed—if African countries do not deliver on the major promises and commitments embodied in the visionary NEPAD framework.

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5

Poverty and Its Eradication

T. N. Srinivasan

Eradication of absolute poverty was the overarching objective of policymakers in most of the developing countries that achieved political independence after the Second World War. They were determined to correct the perceived failures of colonial rule by embarking on a structural transformation of their economies and societies. It should surprise no one that—given the abject poverty of their populations and the then-prevailing low life expectancy at birth; high rates of mortality (particularly infant and child mortality), illiteracy, and malnourishment; and lack of educational and health-care facilities—they viewed poverty as a multifaceted phenomenon and not just a reflection of inadequacy of incomes. A few among them also viewed the absence of participatory democracy as an aspect of poverty. All of them recognized that, given the low level of average income, redistributive policies at best have a limited role (and at worst are counterproductive) in eradicating poverty. They were therefore emphatic about the instrumental roles of rapid growth in income and its better distribution for achieving the objective of poverty eradication.

World Bank President Robert McNamara drew their attention to poverty at the Bank's Nairobi meeting in 1973. Assertions that policymakers in poor countries were unaware of poverty and the need for its alleviation or that they had no clue about human development until the UN Development Program began ranking countries with its index are based on either willful ignorance of relevant facts or merely self-serving statements of international bureaucracies. By raising the issue of poverty and lack of progress toward human development, however, such

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assertions demonstrated clearly that the concerns of policymakers about poverty eradication and human development had remained at the rhetorical level. They had only been translated into achievement in a few countries in the developing world (and only in the last two decades in some of them). An analysis of this situation, in which there were few successes and many failures, is the main focus of this paper. The analysis points to some policy implications, with which the paper concludes.

Determinants of Poverty

Any analysis of poverty must necessarily begin with a definition of the poor and indicators of their poverty. Since there is a large and well-understood literature on this topic, I will be brief. The poor are those whose level or standard of living is below what the society in which they live deems as a minimum that all its members ought to have. Operationally, this social minimum is often identified with the value of a specific bundle of goods and services (the so-called poverty bundle), and anyone whose resources do not enable him or her to acquire this bundle through home production, market purchases, and public provision is poor.[1] Clearly, the poverty bundle is a normative concept. Sometimes it is identified with what is needed to supply the energy requirements (measured in kilocalories a day) for living and working plus other minimal nonenergy consumption (for example, clothing and shelter). But, as Adam Smith noted long ago, poverty norms are based not just on subsistence requirements, but on broader considerations that are specific to the sociocultural and time and space environment. It is worth quoting him:

> By necessaries I understand, not only the commodities which are indispensably necessary for the support of life, but whatever the custom of the country renders it indecent for creditable people, even of the lowest order, to be without. . . . Under necessaries therefore, I comprehend, not only those things which nature, but those things, which the established rules of decency have rendered necessary to the lowest rank of people. (Smith, 1937, pp. 821–22)

Defining a poverty bundle is just the first step. In valuing the bundle, the relevant prices are obviously those that the poor face at the

[1]I am glossing over the well-known issues of extending this individual-based notion to households with many members and differing age-sex compositions.

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time and in the region in which they live. This is not as simple a task as it might seem at first blush. In fact, estimates of the extent of poverty, such as the head-count ratio (that is, the proportion of a population with income or consumption below the corresponding poverty line) are very sensitive to where the line is drawn. The use of shortcut procedures, such as updating a poverty line (that is, the value of a poverty bundle) estimated for one region and time to other times and regions using some price index, could lead to serious biases in the estimates of poverty.

Indeed, global poverty estimates based on a common global poverty line that is updated using country-specific purchasing power parity (PPP) exchange rates (for example, $1 or $2 a day at 1985 dollars at PPP exchange rates) are seriously flawed (see Deaton, 2001a; and Srinivasan, 2001a, for a discussion of the issues). For India, Deaton (2001b) shows that if, instead of using an official consumer price index for updating poverty lines, a price index based on prices actually paid by households (as estimated from a household survey of consumption expenditures) is used, poverty (as measured by the proportion of the population consuming less than the poverty line) in 1993–94 falls to 32.9 percent from 37.1 percent in rural areas and to 18.1 percent from 33.2 percent in urban areas. The disparity widens in 1999–2000: a fall to 21.6 percent from 27.0 percent in rural areas and to 9.5 percent from 23.5 percent in urban areas. Thus using a more appropriate price index reduces the estimated number of poor in urban India in 1999–2000 from around 254 million to 181 million. If only taking millions out of poverty were as simple as changing price indices!

Having illustrated the conceptual and measurement problems associated with estimating poverty, let me turn to the economics of poverty. Whether an individual or a household has adequate resources to purchase the poverty bundle at the relevant prices at a point in time depends, of course, on what that person or household can earn from his or her assets (land, financial, and physical capital) and, most important, from labor (allowing for skills and educational attainments). The functioning of asset and labor markets, as well as of markets for goods and services bought or sold, obviously influences the earnings from assets and their purchasing power. Clearly, if there are no distortions in all these markets and all individuals and households face the same prices, the extent of poverty would be determined by the distribution of assets and labor in the economy. Needless to say in the developing world, market distortions are ubiquitous, and their impacts on the extent and depth of poverty are often serious.

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Land and Tenancy Markets

An overwhelming majority of the world's poor live in rural areas and depend on agriculture, either as tenant farmers with or without some land of their own or as landless laborers (in agriculture and in rural non-farm activities). Clearly, the inequality in the distribution of land owned and the ability to access land for cultivation as a tenant influence the extent of poverty. The functioning of land and tenancy markets also matters. Indeed, in poor countries the cost of transactions in selling or buying land is often very high. A major reason is the difficulty in establishing a claim of ownership because of the absence of any formal land-titling system or because of poor maintenance of records of land titles and the corruption of officials who have the authority to certify ownership.[2] High transactions costs could lock in the poor who own small amounts of land, preventing them from selling their land and leaving agriculture to pursue more rewarding opportunities elsewhere. At the same time, those (including some of the poor) who can profitably use more land than they own are deterred from buying land because of the high costs of transactions.

These high transactions costs for sales and purchases of land need not lock in potential sellers and buyers if land tenancy markets functioned efficiently, with low transactions costs. Thus a potential seller, instead of selling land, could rent it out to others, and a potential buyer could rent land from others without having to purchase it. Further, if conditions in tenancy markets preclude long-term tenancy contracts from being entered into, the resulting lack of security of tenure would inhibit productivity-enhancing long-term investments by both tenants and landowners.

Credit, Insurance, and Financial Markets

In addition to being dependent on agriculture, the rural poor have to cope with uncertainties, some of which relate to the environment for production and consumption (such as weather and disease) and others of which are idiosyncratic (health and mortality rates among humans and livestock). Further, the agricultural production process is one in which inputs have to be committed in advance of the realization of an uncertain harvest, whereas consumption is more certain and more evenly paced over time. It is clear that even if production and consumption were free of any risk and uncertainty, the lack of synchroniza-

[2]In fact, in India there have historically been layers of rights on land through subinfeudation, and often the ownership right is not well defined.

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tion between the two would still require a way to smooth consumption over time. It is also clear that it would be less expensive to achieve such smoothing if access to smooth and efficient credit markets were available than if each individual had to hold inventories of inputs and consumption goods. The need for credit is enhanced if purchased inputs (such as fertilizers and pesticides, energy and fuels, and hired labor) account for a large share of production costs, as in the case of cultivating Green Revolution varieties of crops. With well-functioning insurance markets, insurable risks would be addressed. However, uninsurable risks (or, more precisely, risks that are insurable only at a high cost) are also significant in the rural areas of poor countries.

For well-known and well-understood reasons of moral hazard, the absence of collateralizable assets, poorly functioning legal systems for enforcement of contracts, and the seizure and sale of whatever collateral has been pledged, formal credit and insurance markets in poor countries are either virtually absent or costly for the poor, if not altogether out of their reach. On the other hand, informal arrangements substitute in part for transactions in formal markets (Townsend, 1994; and Udry, 1993). However, the cost of informal transactions is not necessarily low, and in any case, informal arrangements are nowhere near adequate to substitute fully for the incomplete and imperfect functioning of credit and insurance markets.

Even though the poor do not save enough to invest in financial markets (particularly equity markets), they do invest their meager financial savings in the form of deposits in commercial banks, purchase of life insurance policies, and lending in informal credit markets. Clearly, the returns they realize on such investments depend on the functioning of the financial sector, including the banking system.

Product Markets

The efficient functioning of product markets at home and abroad is vital for poor producers and consumers. Needless to say, the extent of integration of national markets and the competitiveness of exports in world markets depend in large part on whether or not transport and communications infrastructure exists—and functions efficiently—to minimize the costs of transportation and of acquiring market intelligence. Insufficient integration would mean that price differentials across markets exist that cannot be arbitraged away. Also, given the uncertainties not only about harvests but also about the prices that will prevail when the harvested output is to be sold, it matters whether national markets for forward transactions exist and how costly it is to store

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commodities for later sale. Another issue of concern for small farmers who are mostly poor is the often large difference between the price they receive for their product and the price the ultimate users of the product pay. This difference could reflect possible monopsony power of processors of primary commodities for sale to consumers. It could also reflect high costs of transportation, insurance, and inspection to ensure that the relevant product standards (including sanitary and phytosanitary standards) are met. To what extent each of these contributes to the price difference is not easily determined and, in any case, would differ from commodity to commodity.

Labor Markets

Most often the only asset that the poor have is their own labor. As in the case of commodity markets, the extent of national integration of labor markets is relevant in ensuring that workers receive the best return for their work. Unlike commodities, the cost of whose movement within and between countries is primarily determined by costs of transportation and insurance, the cost of mobility of labor involves social and legal as well as economic barriers. Another inadequately recognized aspect of labor markets in many developing countries (for example, in South Asia) is that only a small part of the labor force (20 percent or less) is in formal wage and salary employment—the overwhelming majority is in self-employment, often in subsistence farming, handicraft activities, and household-based production for local markets. For them it is not so much the functioning of labor markets but of product and credit markets that is more relevant.

Opportunities for and Returns from Accumulation

I have already referred to returns from investment (if any) by the poor in financial instruments. However, a large share (nearly 50 percent or more) of savings and investment by households in developing countries such as India is in the form of physical assets, which they finance on their own without involving financial intermediaries. These assets include mostly those related to their production activities and some dual-use assets (production and consumption). Two points are worth making. First, how large a share of households' savings is used to finance direct investment in physical assets depends in large part on the functioning of the financial system and households' access to it, which together influence the cost of financial intermediation. Second, leaving aside investment in housing, investment in physical assets involved in household

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production could be viewed as a rough analogue of investment financed by retained earnings by enterprises in industrial countries. In other words, considerations of cost of capital, which are extensively discussed in the literature on investment finance in developed countries, are relevant for analyzing the incentives for using one's own savings to invest in the assets acquired by households in poor countries. Needless to add, these issues are relevant only for those poor households that own household enterprises (farm or nonfarm). Of course, the share of such enterprise-owning households among the poor is likely to be small.

Just as their labor is the major asset owned by the poor, so too their investment in accumulating human capital is likely to be the major component of their investment. Although their poverty limits their saving and investment in any form, it is particularly limiting when it comes to human capital accumulation. Indeed, a major reason that the incidence of child labor is very high in many poor countries of South Asia and sub-Saharan Africa is the poverty of the working children's parents. Such parents cannot afford to forgo the income from a child's work (whether from paid work or in terms of unpaid contributions to the household's farm or nonfarm enterprise). Besides, the out-of-pocket costs to parents for sending their children to school are often substantial.

Thus, for poor parents, both the out-of-pocket and the opportunity costs of investing in human capital accumulation by educating their children are high. Even in the unlikely event that the out-of-pocket costs of sending children to school are negligible (for example, because the state provides quality educational services free of charge), if poverty-induced opportunity costs are high, children are less likely to be sent to school. Three serious consequences arise. First, the earning prospects of uneducated (or less-educated) children in their adult working lives will be reduced compared with their competitors in labor markets. Second, unless labor market conditions improve in their adult life compared with those that prevailed in their childhood, they are likely to end up as poor as their parents were and, as such, unlikely to educate their own children. The prospect of perpetuating poverty across generations in such circumstances cannot be ruled out. Third, since some minimal education is often needed for an individual to participate effectively in the political and social processes that make decisions affecting his or her social and economic prospects, the uneducated will in effect be unable to exercise their right to participate. I should add here that national and international attempts to eradicate child labor through restrictions on imports or consumer boycotts of goods produced by children are not likely to succeed unless the basic cause of child labor is addressed, namely, the parents' poverty.

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Institutions

I have discussed above the effects of the absence or poor functioning of one of the most important institutions, namely, the market. Two other institutions affect the prospects of all agents in the economy: institutions of governance (that is, governments at all levels in each nation as well as multilateral intergovernmental institutions and legal systems) and nongovernmental (so-called civil society) institutions. It is obvious that government policy interventions in the economy are major factors in influencing not only the extent of poverty at a point in time but, even more important, the trends in poverty over time. I will return to government policies in the next section. Endemic corruption often distorts the adoption, enforcement, and effectiveness of policy interventions. Tackling corruption is a major challenge of governance in developing countries. It is a phenomenon that has been with us for ages—in fact, the *Arthasastra*, a Sanskrit treatise on statecraft dating from the fourth century B.C., lists more than 50 ways in which officials could be corrupt. Of course, the harmful effects of corruption on inflows of foreign investment have attracted attention. Nonetheless, China, a country in which corruption is thriving, has attracted large flows of investment, particularly from overseas Chinese who apparently are better than non-Chinese at operating in the corrupt Chinese system. The use of corrupt practices by transnational enterprises, often with the connivance of governments in their own countries, has received considerable attention in the literature. Other than to reiterate the obvious fact that the poor suffer most from corruption in their societies, I will not discuss it any further.

The recent literature on social capital has paid a great deal of attention to the role of nongovernmental civil society institutions. The Protestant ethic and the rise of capitalism, Confucian ethics, the caste system, the extended family, the place of women in the family and society, communitarianism, individualism, and many other social norms have been analyzed for their economic effects. Interestingly, sometimes the very same institution that was once viewed as inhibiting economic progress is later seen as conducive to it. For example, the institution of the extended family, once considered an obstacle to increasing savings and a source of nepotism, was later judged to save the costs of monitoring nonfamily wage labor, and more generally to reduce the costs of family-based activities in which mutual trust is important.

There can be no doubt that nongovernmental institutions, which in part substitute for absent government institutions, as well as social and religious norms and injunctions that govern individual and household behavior, play a major role in all societies. Some of these constitute

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social capital. They can enable or frustrate the market mechanism in allocating resources efficiently at a point in time and over time just as much as can the presence or absence of legal mechanisms for defining property and contractual rights and their enforcement. Other than drawing attention to their importance and referring to particular institutions below, I will not discuss them further. In any case the literature offers little guidance as to how to accumulate social capital.

Poverty Eradication Mechanisms

The mechanisms for alleviating, if not eradicating, poverty can be divided into two broad categories. The first operates by directly affecting the resources that individuals and households command. The second operates indirectly by affecting the economic, political, and social environment in which individuals and households function. There are policy interventions in each category.

The resources that individuals (poor and nonpoor) command can be influenced by either redistribution or productivity-enhancing mechanisms. For example, if individuals are poor because the assets they own are too meager, then a sufficient redistribution of assets from the nonpoor to the poor, if feasible, would eliminate poverty. Whether such a once-for-all redistribution permanently eradicates poverty is another matter. There are analytical models in which asset redistribution has only a transient effect and leaves the long-run or steady-state equilibrium distribution unchanged. The dynamic effects of asset redistribution could reinforce the static effects of enhancing the resources the poor command. For example, because of their lack of access to credit (in part due to their not having enough assets that may be collateralized) the poor might forgo some profitable investment opportunities. Redistributing assets in their favor would enable them to take advantage of such opportunities, both directly, by augmenting their investible resources (from asset earnings), and indirectly, by increasing their assets that may be used as collateral and thus enabling them to access credit. On the one hand, if these dynamic effects are strong enough, a modest redistribution of assets would ensure that poverty is eradicated in a relatively short time. On the other hand, if the conventional belief that the marginal propensity of the poor to consume is close to unity is correct, there would be no dynamic effects.

Apart from the static and dynamic effects of asset redistribution on the poor, there are economy-wide effects. For example, if credit markets are absent, so that investment is constrained by the amount of resources one owns, and marginal returns to investment diminish, then, if assets are

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unequally distributed, the rich would have a lower marginal return to investment than the poor. A redistribution of resources to the poor from the rich would raise the average rate of return to investment and hence the rate of growth of the economy. This example is an extremely simple illustration of a much more complex interrelationship among credit market imperfections, inequality, and growth. It is also clear that tax and redistributive policies could be used to influence the dynamics of growth and inequality (for surveys of relevant analytical and policy issues, see Aghion, Caroli, and Garcia-Poanaloma, 1999; and Benabou, 1996).

The dominant asset in poor agricultural economies is land. Land in most poor countries is unequally distributed, with the poor having very little or no land. Redistributive land reform in the early years of development in Korea and Taiwan Province of China has been seen as a contributory factor to their later rapid growth and their success in virtually eliminating poverty.[3] Successful land reforms, however, have mostly been initiated and implemented by foreign occupiers (Americans in Japan, mainland Chinese in Taiwan Province of China) or under foreign pressure (U.S. pressure on Korea).

Tenancy Reform

It is unlikely that radical land reforms would come about in poor agrarian societies through nonrevolutionary domestic political processes. However, tenancy reforms are more frequently undertaken. In the Indian state of West Bengal, a left-wing government was elected to power in 1977. It launched "Operation Barga" to implement and enforce the long-dormant agricultural tenancy laws that regulated rents and the security of tenure of sharecroppers. Banerjee, Gertler, and Ghatak (2002) show that Operation Barga explained around 28 percent of the subsequent growth of agricultural production. Shaban's (1987) study of eight Indian villages and the study of Laffont and Mantoussi (1995) based on Tunisian data show that a shift from sharecropping to either fixed-rent tenancy or owner cultivation raises productivity significantly. Such increases in productivity following tenancy reforms can raise the incomes of the poor.

Raising the Productivity of the Poor

Redistributive land and tenancy reforms are only two reforms among many that could augment the resources commanded by the poor or raise

[3]The financial crisis of 1997 in Korea did raise poverty levels temporarily.

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the returns on the assets they own. Others include subsidizing the consumption of the poor (for example, providing a limited ration of essential items of consumption such as food) or their investment in human capital (education subsidies). In practice, subsidy policies work rather poorly: the subsidies are not often well targeted at the poor. Also, the cost of transferring a dollar to the poor through subsidy schemes (particularly poorly targeted ones) often exceeds a dollar by a substantial margin. Hijacking by the nonpoor of subsidies intended for the poor occurs as well. In India there is a public distribution system (PDS) through which fixed amounts per person of food grains and a few other essential commodities are sold at subsidized prices. The system, which is a legacy of urban rationing during the Second World War, remained mainly urban and untargeted for several years before it was extended to rural areas. More recently, targeting has been introduced by limiting the subsidies to the poor. Until the late 1960s, when the Green Revolution took hold, the supplies for the PDS were compulsorily procured from farmers and traders at below-market prices (the so-called procurement prices). As the Green Revolution took hold and market prices declined, procurement operations in effect became price support operations, under which the government stood ready to buy as much as was offered at procurement prices. It should cause no surprise that a farm lobby soon emerged to agitate for every rising procurement price.

The cost of food grains distributed through the PDS included the procurement price plus the cost of transportation and storage by the public sector agency, the Food Cooperation of India (FCI). Again it should cause no surprise that the FCI was grossly inefficient, so that over time the subsidy cost (the difference between the cost and the sale or issue price to the purchasers from the PDS) widened. The economic cost (Ministry of Finance, 2002, Table 5.9) to the FCI of a kilogram of rice was 11.74 rupees, and the price at which it was sold to poor purchasers was Rs 5.65. Nonpoor purchasers paid a higher, but still subsidized, price of Rs 8.30. Major subsidies of the central government alone, of which food subsidies form a large part, are budgeted at 1.6 percent of GDP for the year 2002–03 (Reserve Bank of India, 2002, Table 4.6). As purchases by the PDS did not grow as fast as the volume of grains procured by the FCI, the stocks held by the FCI grew, reaching 60 million metric tons in 2001. This is not the place to discuss in detail the depressing political economy of the PDS in India. Almost all politicians are united in their opposition to dismantling the PDS (ostensibly because it is pro-poor). The farm lobby is interested in ensuring that the PDS stays, so that it provides price support at rising procurement prices. The employees of the FCI (along with their political backers) oppose its privatization or

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dismantling. Rao and Radhakrishna (1997) analyzed India's PDS from a national and an international perspective. They found that in 1986–87, PDS and other consumer subsidy programs accounted for only about 3 percent of the expenditure per capita of the poor, and their impact on poverty and the nutritional status of the poor was minimal. Abolition of the PDS would have had a negligible impact on the rural poor, who are the majority of the poor. The central government alone spent more than 4 rupees to transfer 1 rupee to the poor.

Raising the Productivity of the Poor

Raising the productivity or returns to the assets of the poor would alleviate their poverty. As noted earlier, the chief asset of the poor is their labor. Thus a sustained increase in real returns to labor in wage and self-employment would contribute significantly to poverty alleviation. Clearly, if there is an outward shift in the demand for wage labor and for goods and services produced by the self-employed, real returns to labor will increase. Needless to say, such an outward shift is most likely to occur in a rapidly growing economy. Returns to the abundant factor, which in most poor countries is unskilled labor, would rise with trade liberalization. Increasing the human-capital endowments of the poor would also raise the productivity of their labor. This can be done by providing incentives for the poor to invest in human capital on their own, and through public expenditure on, and improving the access of the poor to, public education and health care programs.

Human Capital Accumulation

Public policy interventions could influence directly the investment in human capital by the poor by subsidizing the out-of-pocket costs to the poor of using publicly provided educational and health-care services. As the enormous literature on human capital has emphasized, the fertility decisions of households have an impact on human-capital accumulation decisions through the so-called quality-quantity trade-off. This means that having fewer children would enable a couple to spend more on the education, nutrition, and health of each child. Policy initiatives that combined the provisions of family planning and prenatal health-care services to households, and improved the quality of and access to schooling, successfully brought down total fertility rates and raised the school attainment of children in Bangladesh, particularly poor children. Other programs that provide incentives for parents to keep their children in school (particularly female children), such as

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midday meal schemes in some states of India and the Progresa program in Mexico, have been successful. Differences in total fertility rates across countries and subnational units within nations have been shown to be lower in those countries and units in which the social status of women is higher, and their educational attainments and labor-force participation rates are higher as well. Given the well-known bias against women and female children within households and in society, any social or state intervention that reduces this bias will have a positive impact on the well-being not only of women but also of female children. Public expenditure on health and sanitation, by reducing the incidence of communicable diseases and raising life expectancy, contributes directly to the productivity of the poor and indirectly to making investment in human capital more attractive. The tragic consequences of the AIDS epidemic on productivity and life expectancy have been dramatic. The poor bear a disproportionate share of the losses.

It is now well recognized that even if governments invest in schools and health-care service centers so that they are well spread, particularly in rural areas where the poor live, such investments may not increase school enrollment or improve the health of the rural poor for many reasons, the foremost among them being the nonnegligible opportunity cost to the poor of accessing the services, even if they are provided free of charge. Although high opportunity costs reduce the demand for these services, serious supply problems often exist as well. Governments often do not anticipate and provide for the operational costs of running schools and health clinics once they are built. This results in fewer teachers being hired than would be needed to provide good-quality services, and less resources being available for purchasing essential school supplies and medicines.

Governance problems frequently compound the resource constraints: these include ensuring that teachers and health care personnel in fact show up at schools. In systems where hiring and firing decisions are made centrally, local authorities and means of services (parents and such) have no say in monitoring the performance of staff. Absenteeism and poor performance of staff can be serious problems. For example, in the state of West Bengal in India, ruled since 1977 by a left-wing coalition headed by the Communist Party of India (Marxist), the government has been powerless to tackle absenteeism by teachers, who are shielded by a powerful union affiliated with the political parties in the ruling coalition. As a result, the educational attainments of children in West Bengal are worse than in some other Indian states that are comparable in terms of real product and expenditure on social sectors per capita. On the other hand, the education-guarantee project in the state

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of Madhya Pradesh, in which responsibility for teacher hiring and performance monitoring was transferred to local authorities and parent representatives, has made a perceptible impact on enrollments, dropout rates, and other indicators of performance. Failures of the public school system can, and often do, drive parents (particularly poor parents) to send their children to uncertified and poorly monitored private schools, including religious schools in which the time devoted to nonreligious subjects such as arithmetic, science, history and civics, language, and literature is woefully inadequate.

Thus far I have illustrated some possible public-policy interventions that, by design, have poverty alleviation as their objective. These include various subsidies and other mechanisms targeted at the poor. But the fact (if it is a fact in a given context) that such interventions did improve the condition of the poor is in itself only a necessary, and not a sufficient, condition to demonstrate that the return on social and private resources spent (in terms of social and private benefits from such improvements) is comparable to the return from alternative uses of such resources. The example I cited of the Indian government spending over 4 rupees to transfer 1 rupee to the poor through the PDS is unlikely to meet this test. A mechanism for just giving away a rupee to the poor would surely cost less. It is fair to say that it is the exception rather than the rule for a rigorous social-cost-benefit test to be applied either before a program is implemented or afterward. In fact, it is common for governments to refuse to undertake a baseline survey and to build in a mechanism for a proper ex post social-cost-benefit evaluation of an intervention that affects large numbers of people. Interestingly, the Progresa program in Mexico is an exception: areas in which Progresa was to be implemented were deliberately chosen randomly. This enabled a scientifically sound evaluation of its effects. It is understood that few politicians (or even international agencies) would relish the prospect of their pet intervention programs being subjected to a rigorous scientific evaluation. This is perhaps the most likely reason that Progresa is an exception.

Let me now turn to those processes and policies that do not have poverty alleviation as their objective but nonetheless have a major impact on the extent of poverty and its trend over time. Indeed, a large body of evidence shows that these processes and policies have a far greater impact on poverty alleviation than those with a narrow focus on poverty alleviation. I will discuss the four most important of these, all of which are interrelated: openness to foreign trade, capital flows, and technology, as well as domestic market integration; public spending on social and physical infrastructure; macroeconomic stability; and aggregate growth.

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Openness

In the standard Heckscher-Ohlin-Samuelson model of international trade, opening an economy to trade or reducing trade barriers raises the return to its most abundant factor and reduces that of its least abundant factor.[4] Since many of the countries in which most of the world's poor live, such as China and the countries of South Asia, are abundant in unskilled labor, opening them to trade would raise the return to unskilled labor, a factor that is owned mostly by the poor. Among the scarce factors is capital—lowering the return to capital through trade liberalization reduces the cost of capital. Poor people who do not have capital of their own, but borrow what they use, gain. Thus trade liberalization is a pro-poor policy. Although scarce factors lose from trade liberalization, the gains to abundant factors more than offset the losses to scarce factors, so there are gains to the economy as a whole. In principle, the losers can be compensated since there is a net gain.

This traditional argument about static factor price effects and gains from trade assumes that resources move smoothly and without cost from import-competing to exporting activities. Obviously, if resources cannot or do not move, exporting industries will not expand as import-competing industries contract because of increased competition from imports after trade liberalization, thus creating unemployment. This somewhat extreme but elementary argument against trade liberalization has been raised by Stiglitz (2002, p. 59), who says, "It is easy to destroy jobs, and this is often the immediate impact of trade liberalization, as the inefficient industries [those created under the protectionist walls] close down under pressure from international competition." Since he assumes that no new, more efficient jobs would be created, he concludes, "moving resources from low-productivity uses [in inefficient industries] to zero productivity [to unemployment] does not enrich any country." Trite but true! But the lesson is surely not that factors should be kept employed in less-productive uses forever, but rather that, while firmly and credibly committing to removing trade barriers at the end of a reasonably short time, policymakers should remove impediments to labor mobility.

There are also dynamic gains from trade liberalization. Trade is a vehicle through which technical knowledge is exchanged among trading partners. Empirical studies (Coe, Helpman, and Hoffmaister, 1997)

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[4]I will deliberately ignore other models of trade in which scale economies, imperfect competition, and product differentiation play a major role, for the reason that they are largely irrelevant for the trade policy choices of most poor developing countries, except a few large ones such as Brazil, China, and India.

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suggest that total factor productivity (TFP) in poor countries, which do not have domestic research and development capacities, is higher the greater is their trade with industrialized countries, which account for the bulk of research and development in the world. (This is particularly the case with imports of equipment embodying technical knowledge.) Lastly, openness could raise aggregate growth, at least in the short and medium run, through several channels, including higher investment if the gains from liberalization are not entirely consumed, and greater TFP. Several empirical studies report a strong association between openness and growth (Sachs and Warner, 1995; Dollar and Kraay 2000; and Frankel and Romer, 1999). There are also critics of their findings (Rodriguez and Rodrik, 1999). However, those who find strong empirical support for the positive association between openness and growth, as well as their critics, use the same and, in my view, faulty methodology, namely, the blunderbuss of cross-country growth regressions. Studies in the 1970s and 1980s (Little, Scitovsky, and Scott, 1970; Bhagwati, 1978; Krueger, 1978; and Balassa, 1971), which adopted a more nuanced and robust methodology of studying individual country policies in a comparative framework, provide sounder empirical evidence for the association of growth with openness.

Foreign direct investment (FDI), when it is not merely a response to high tariff barriers (tariff-jumping investment) and tax inducements but is attracted by low labor costs in poor countries (after adjusting for productivity differences) and the prospect of using them as an export platform, can contribute to poverty alleviation. The removal of barriers and controls on financial capital flows in countries with fragile domestic financial sectors has proved to be deleterious to the poor, as the Asian and other recent financial crises demonstrated. Stiglitz (2002) is eloquent on the dangers of liberalizing financial capital inflows. But once again the relevant lesson is not that capital controls are intrinsically and always beneficial. It is that financial liberalization, like trade liberalization, is beneficial if the domestic financial sector is strong and undistorted. Therefore, policymakers, while credibly and firmly committing to liberalize capital flows at a specific future date, should use the time until then to reform the domestic financial sector and create an appropriate prudential regulatory framework.

Domestic Market Integration

In some developing countries, particularly large ones such as India, there are restrictions, including taxes, on internal trade. In India, there are interstate sales taxes on some commodities and restrictions on

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movement of food grains on private account even between districts within states. The Essential Commodities Act (once again a vestige of controls imposed during the Second World War) gives the government broad power to intervene in internal trade in such commodities. Price controls are also quite frequently imposed. Panterritorial pricing, which requires that the same price be charged throughout the country, is another restriction that has been imposed in some African countries and in India. Clearly, such a requirement thwarts the forces of regional and local comparative advantage from operating and in effect is a means for cross-subsidization of producers in regions that are more distant from the markets—and less efficient—by producers in closer and more efficient regions. Producer price controls are likely to affect poor and small producers adversely compared with larger producers. Attempts to stabilize prices received by commodity producers and to exploit market power in world markets through marketing boards failed miserably. Their inefficiency and adverse distributional effects in Africa and elsewhere are well known. More generally, the less the integration of domestic markets, the greater is the inefficiency of domestic resource allocation. In all probability, the poor bear a disproportionate share of the cost of such inefficiency.

I should also mention production controls, such as the "small-scale industry reservation" in India, which reserved certain labor-intensive products for production exclusively by small-scale producers. Although prima facie this might appear to confer an advantage on poorer producers, in fact it has operated as a tax on efficiency and prevented India becoming internationally competitive in such products. Other forms of production and export controls are prevalent in developing countries and almost always hurt the poor.

Infrastructure Spending

I have already discussed the possible pro-poor impact of public spending on social sectors such as education and health. In many poor countries, economic infrastructure projects (irrigation and flood control works, power, transport and communications, and ports) are largely publicly owned and operated, often inefficiently and at a high cost. Although privatization (accompanied or preceded by the creation of regulatory agencies) is the appropriate remedial policy in many areas, there are situations in which it is not realistic. In such situations, public spending on infrastructure could contribute to poverty reduction and growth. In another study, Fan, Hazell, and Thoret (1999) analyze the more or less steady decline in rural poverty in India since the late

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1970s. They use state-level data to test an econometric model that allows the estimation of the marginal contribution of different categories of public infrastructure expenditure on poverty reduction. They find that the marginal benefit in terms of poverty reduction was the highest for expenditure on roads—such expenditure also contributed significantly to productivity growth. Expenditure on agricultural research and extension yielded the largest marginal benefit in terms of productivity growth, while also yielding significant benefits in terms of poverty reduction. Expenditure on education had the largest impact on poverty reduction, largely because of the increases in nonfarm employment and rural wages it induced. By contrast, investment in irrigation had only a small impact on poverty but had the third-largest impact on productivity growth. Lastly, public spending on rural and community development, including the integrated rural development program, reduced poverty, but to a smaller extent than did expenditure on roads, agricultural research and development, and education. The authors' explanation for this difference is that, although spending on rural development is effective in reducing poverty in the short run, since it has little impact on agricultural productivity, it contributes little to sustained and long-term poverty reduction. This confirms that although employment guarantees, food-for-work, and other such programs certainly alleviate poverty and avoid problems of leakage of benefits to the nonpoor because of their inherent self-selection feature (that is, only the poor avail themselves of them), unless the program activities in which the poor are employed yield productivity gains, their impact on poverty reduction in the long run will be minimal.

Macroeconomic Stability

An unstable macroeconomy, especially an inflationary environment, is particularly damaging to the poor. In some countries of Latin America, wage labor is the dominant form of employment, and wages are indexed to inflation. But in other parts of the world where self-employment and casual work are dominant, there is no indexation of earnings. In such contexts, inflation is the cruelest tax—it hurts the poor most because their earnings are not indexed to inflation and they have no opportunities to invest in assets that provide hedges against inflation. This is not to say that indexing (particularly backward indexing) is the appropriate policy to mitigate the ravages of inflation. It is not appropriate because, among other things, it can perpetuate inflation. The right policy is to avoid inflation and to have a stable macroeconomic environment. There are other channels through which macroeconomic

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instability hurts the poor, two of them being lower aggregate growth and greater risk of financial collapse.

Growth

The instrumental roles of rapid aggregate growth and, secondarily, of a more equitable distribution of the fruits of growth in eradicating poverty were recognized long ago by policymakers in developing countries. For example, in 1940, before Indian independence, a national planning committee chaired by the future prime minister, Jawaharlal Nehru, completed its work on elaborating a development strategy for an independent India. The overarching objective of the strategy

> . . . was to insure an adequate standard of living for the masses; in other words, to get rid of the appalling poverty of the people . . . the irreducible, in terms of money, had been estimated by economists at figures varying from Rs 15 to Rs 25 per capita, per month (at prewar prices) . . . [To] insure an irreducible minimum standard for everybody, the national income had to be greatly increased, and in addition to this increased production there had to be a more equitable distribution of wealth. We calculated that a really progressive standard of living would necessitate the increase of the national wealth by 500 or 600 percent. That was, however, too big a jump for us, and we aimed at a 200 to 300 percent increase within ten years. (Nehru, 1946, pp. 402–03)

India embarked on planning for national development in 1950. As early as 1960, when two five-year plans had been implemented, a socialist member of parliament questioned whether the fruits of growth in the two plans were reaching the poor. In his response, Nehru said:

> Again it is said that the national incomes over the First and Second Plans have gone up by 42 percent and income per capita by 20 percent. Now a legitimate query is made: where has this gone? To some extent, of course, you can see where it has gone. I sometimes do address a large gathering in the villages, and I can see that they are better fed and better clothed, they build brick houses and they are generally better off. Nevertheless, that does not apply to everybody in India. (Government of India, 1964, p. 1)

Nehru followed up his response with the announcement of a committee to inquire into the trends in income distribution and standards of living. Even as the committee was engaged in its task, the Perspective Planning Division of India's Planning Commission produced a 15-year development plan for poverty eradication covering the period 1960–61 to 1975–76, with a growth target of 7 percent a year. What is more interesting is that the plan explicitly recognized that there were individuals and households in the economy who, for various idiosyncratic and

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locational reasons, were weakly connected to the income generation processes of the economy, and that their poverty could not be alleviated simply by more-rapid growth in incomes. It advocated a two-pronged strategy for poverty alleviation: for the large majority of the poor, who are well connected to the production and income-generation activities of the economy, rapid income growth would eradicate poverty. For the weakly connected poor, transfers would be necessary.

More-recent empirical evidence (World Bank, 2001) suggests a significant association between aggregate growth performance and improvements in human development indicators, including the incidence of poverty. However, any association between aggregate growth and reduction in national poverty does not imply either a one-way causal relation between growth and poverty or even that the association would hold for all countries and for all periods. One has to identify the possible mechanisms through which, on the one hand, aggregate growth could affect, positively or negatively, poverty at the national or subnational level and, on the other hand, how levels and trends in poverty could influence growth, again in either direction. Clearly, there is no reason to presume that all such mechanisms need operate everywhere and at all times or, even if they do, that they operate with the same intensity. Further, there may be leads and lags involved in their operation—for example, it could take several years before an acceleration in growth results in poverty reduction. In addition, only sustained increases in growth, and not any temporary and reversible increases, could bring about a reduction in poverty. Moreover, growth, poverty, and inequality are endogenous outcomes of economic, social, and political processes within a nation as well as of trends in the world economic and political environment insofar as it affects domestic processes. These processes themselves could in part be endogenous and interact with each other. The speed, strengths, and nature of interaction could and would vary over time and across countries. For all these reasons it is not easy to dismiss conclusively and convincingly through empirical analysis such statements as, "Aggregate growth is not enough" or "No poverty reduction is possible without aggregate growth." Both could be seen as true and false, in the sense of being seemingly valid for some countries or periods and not valid for other countries or periods.

Thus, no universal (valid for all countries) and eternal (valid for all periods) causal relation between growth and poverty reduction can be derived from economic theory, and hence one cannot hope to find it empirically. Yet it turns out that poverty declined substantially in the last two decades of the twentieth century. This is evident in the greater integration of the developing economies with the world economy

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(through the process of globalization) and more-rapid growth in many of them. This is particularly true since the 1980s of the world's two largest developing countries, China and India. The so-called miracle economies of East Asia adopted an outward-oriented development strategy much earlier, in the mid-1960s; achieved rapid growth; and virtually eliminated poverty until the financial crisis of 1997 temporarily increased poverty. I turn briefly in the next section to their performance.

Growth, Openness, and Poverty

East Asia

Since the mid-1960s—when they adopted an outward-oriented development at a time almost every other developing country was inward-oriented—the East Asian economies (Hong Kong SAR, Korea, Singapore, and Taiwan Province of China) achieved spectacularly high rates of growth and succeeded in achieving an economic and social transformation that had taken the industrialized economies of Europe centuries to accomplish. Their Southeast Asian neighbors—Indonesia, Malaysia, and Thailand—also achieved high rates of growth and rapid reductions in poverty. Although the financial crisis of 1997–98 did reverse their attainments (particularly in employment generation and poverty reduction), the quality of life of the populace remains largely intact and, with the exception of Indonesia, growth has resumed, although not at precrisis rates.

The success of East Asia has been studied extensively by many scholars. Nobel laureate Robert Lucas (1993) uses the success of these countries as a background for developing a theoretical framework in which the two distinguishing characteristics of East Asia (compared with South Asia)—namely, outward orientation and initial human capital endowments (and subsequent accumulation)—play a crucial role in generating sustained and rapid growth. The World Bank (1993) published its study of East Asia in the same year. Quibria's study (2001) is one of the most recent attempts to draw lessons from the East Asian miracle.

Quibria correctly points out that far too many, and often conflicting, lessons have been drawn by different scholars from ostensibly the same set of facts. Studies by the World Bank (1993), Leipziger and Thomas (1997), and Yusuf (2001) do not draw identical lessons, and even if some lessons are the same, their ranking in terms of importance differs. Quibria's revisit to the East Asian miracle uses some new evidence and revises, if not reverses, some of the earlier lessons.

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The World Bank (1993), for example, emphasized the importance of two "facts"—that initial endowments of human capital were favorable and that the fruits of growth were well distributed among all segments of the population—in contributing to East Asia's success. Quibria's reading of the evidence raises doubts about these "facts." The reductions, during the 1970s and 1980s, in inequality in Hong Kong SAR and Malaysia were modest and were from high levels by international standards. In Thailand inequality increased, and it remained constant in Singapore and in Taiwan Province of China. Quibria finds that the claim that these economies had favorable initial human capital endowments or an egalitarian land distribution following land reforms has no solid basis. In his judgment the main factor in explaining their success in poverty reduction is not any radical improvement in income distribution, but rather rapid economic growth. This growth in turn was founded on high rates of investment, sustained by a congenial investment climate. The congeniality of the climate was due to the market orientation of these economies, supported by a policy package whose critical element was openness to trade and technology. Since openness, at its core, creates opportunities, it can succeed only if the opportunities are taken. For this to happen, a set of complementary, credible, and stable policies that ensured a sound and stable macroeconomic environment, a flexible labor market, and incentives that favored productive rather than rent-seeking activities is needed. The East Asian economies had these, and their authoritarian regimes and efficient bureaucracies, insulated from politics, facilitated their adoption.

China and India

Quibria contrasts East Asia with South Asia and finds the latter deficient in many respects. However, even South Asia, and particularly its largest economy, India, performed well in the last two decades. Of course, the star performer of the two decades was the People's Republic of China. According to the World Bank (2002), both countries enjoyed historically unprecedented average rates of growth of GDP at around 10 percent and 6 percent a year, respectively, during 1980–2000. Fewer than 10 of over 200 countries covered by the study exceeded India's growth rate, and none exceeded China's. Poverty in both countries declined substantially during the two decades of rapid growth, albeit at different rates.

In India, annual poverty estimates based on household expenditure surveys are available from the 1950s on. These suggest that poverty as measured by the head-count ratio fluctuated around a level of 50 percent

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without any downward trend through 1977–78, when it was 50.5 percent and 40.5 percent in rural and urban areas, respectively. From then on there was a decline (Table 1 in Srinivasan, 2001b). Deaton's (2001b) estimates cited earlier show that the poverty ratio fell to 25.3 percent in 1999–2000 from 39 percent in 1987–88 in rural areas, and to 9.5 percent from 22.8 percent in urban areas.

Unlike the Indian data, Chinese poverty data based on household surveys are relatively recent—official poverty lines and poverty head counts going back to 1978 were first announced in 1994, superseding some earlier ad hoc estimates. These official data show that rural poverty has been virtually eliminated, falling from 30.7 percent in 1979 to 9.5 percent in 1990 and to 4.6 percent in 1998 (Park and Wang, 2001). A World Bank estimate quoted by the same authors, on the other hand, put rural poverty in 1990 nearly four times as high, at 42.8 percent; and it then fell to 24.2 percent in 1997. Although the estimated levels of poverty differ substantially between official and World Bank estimates, the trend is similar—a halving of poverty between 1990 and 2000 (Srinivasan, 2002, Tables I and II). An analysis of the factors behind the decline in poverty and the differences between the Chinese and Indian experiences is useful in understanding the interactions among openness, growth, and poverty reduction and the role of development strategies in these.

Let me begin with a bit of economic history. Maddison's (2003) historical analysis suggests that China and India had the same real income per capita in 1870. But by 1950, when the Communist regime took over, China's income per capita had *declined* by 17 percent while India's had *increased* by 16 percent. It took nearly two-and-a-half decades, that is, from 1950 to 1973, for China to recover the lost ground, with double India's rate of growth of income per capita. It is reasonable to presume that China and India again were at roughly the same level of income per capita in 1980, two years after Deng Xiaoping abandoned the Maoist economic strategy that had led to the death of 30 million people or more and initiated systemic reforms. India's liberalization began in the 1980s, but systemic reforms came only after the macroeconomic crisis of 1991. However, although both economies experienced an acceleration in growth during 1980–2000 compared with the previous three decades, China's average growth rate of income per capita, at nearly 9 percent a year, far exceeded India's 4 percent a year, so that China's income per capita was nearly 70 percent higher than India's by 2000. The differences in the rate of decline in poverty (85 percent in China between 1978 and 1998 and 50 percent in India between 1977–78 and 1999–2000) seem consistent with faster growth in China's income per capita (Srinivasan, 2002, Tables IIIA and IIIB).

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It is most likely that the differences in the reform and growth processes of the two countries also contributed to the differences in growth rates and their impact on poverty outcomes. Chinese growth was faster and seems to have been more pro-poor. Not only did China continue to save and invest a far higher proportion of its GDP than India, but its integration with the world economy became far deeper as well. Its share of merchandise trade in GDP, albeit an imperfect proxy for global integration, rose to nearly 44 percent in 2000 from approximately 13 percent in 1980. In India the share fluctuated around an average of 12 percent until the opening of the 1990s and has since risen to 20 percent. Another aspect of global integration, namely, inflow of FDI, also showed similar differences: the ratio of FDI to GDP in China grew from virtually zero when the reforms began in 1978 to 4.3 percent in 2000. In India, even after a decade of reforms, the ratio is only 0.6 percent (Srinivasan, 2002).

The sequencing of reforms was also somewhat different in the two countries. China reformed its agriculture first by abolishing collectives, introducing the household responsibility system, and reducing mandatory deliveries of output to the state by farmers, thereby enabling farmers to produce for the market. India's agriculture, while always in the private sector, was insulated from world markets and riddled with government interventions in the domestic market for agricultural inputs and outputs, whose net effect was adverse to agriculture. The Indian reform process is still to be extended to agriculture. Clearly, the fact that China reformed agriculture first, and achieved spectacular results for several years, not only provided credibility to its reform process but also increased the incomes of the poorer segments of the Chinese economy. In India, agriculture in particular and the rural economy in general have yet to be reformed systemically. Until that happens, not much acceleration in reducing the rate of rural poverty can be expected.

Although India and China reformed their external sector by reducing tariff and nontariff barriers, as noted earlier, China's opening went much deeper. In part this was because, while opening the special and coastal economic zones for foreign investment, China in effect allowed foreign investors 100 percent ownership and the freedom to hire and fire workers and provided an excellent infrastructure. In all these respects India lagged behind. Further, India's reservation (until very recently) of labor-intensive products such as garments, leather products, and others to small-scale industry prevented the full exploitation of opportunities from its opening. China increased its share of world exports of labor-intensive products, while India struggled to maintain its slow development and in fact lost ground in some products. India's shallower integration

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and failure, owing to lack of domestic policy reform, to take advantage of the opportunities in the world market limited not only the growth-enhancing impact of trade reform but also, and more importantly, its poverty-reducing effect.

In at least two other respects, the Chinese and Indian reforms differed significantly. These differences favored China both with respect to growth and with respect to poverty alleviation. The first difference is in their approaches to the reform of state-owned enterprises. The share of investment in these enterprises continues to be high in both economies (about 30 percent in India and two-thirds in China in 2000), and their employment has not fallen significantly despite the fall in their share of total output. These similarities notwithstanding, there is no Indian counterpart to China's dynamic township and village enterprises, which by all accounts were labor-intensive and provided employment opportunities to the poor. The second area in which India lagged and continues to lag behind China is in the availability of reliable and affordable infrastructure, particularly electric power. Whereas China has succeeded in attracting foreign investment into this vital sector, India has failed to do so.

Impact of Growth, Globalization, and Inequality

One of the claims of those opposed to globalization is that it widens inequalities in income and wealth both within countries and between countries. Careful empirical support for this claim is nonexistent: such assertions are based only on estimates of inequality measures derived from noncomparable data over time and across countries and questionable methodologies. Since some of these measurement problems are less serious in subnational comparisons, let me turn to the subnational impacts of growth and trends in poverty in China and India.

There is some evidence that, in the period when both countries liberalized their foreign trade and introduced other reforms, regional disparities widened. To a certain extent, this is natural: those regions (and individuals) that are better placed initially to take advantage of the opportunities opened up by reforms or other factors—such as, for example, the information technology revolution—are likely to grow faster and become richer. For example, India's phenomenal success in software is still confined to a few cities in the South and West. The real issue is not one of increasing regional disparities, but whether the socio-economic system will enable the initially disadvantaged regions and individuals to catch up. If it does not, the social and political consequences could be serious and could lead to secessionist threats.

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The evidence of a possible rise in regional disparities comes from the trends in poverty in India between rural and urban areas and differences between two groups of states. The trends in rural and urban poverty are very similar until 1990 (the year prior to reforms) and then diverge, with urban poverty continuing to fall while rural poverty almost stagnates. Also, until 1990–91, the trends in rural poverty were similar between Group 1 states (Andhra Pradesh, Gujarat, Karnataka, Kerala, Maharashtra, Tamil Nadu, and West Bengal) and Group 2 states (Bihar, Madhya Pradesh, Orissa, Rajasthan, and Uttar Pradesh), but after the crisis and reform year of 1991–92, poverty declines in Group 1 states and stagnates in Group 2 states. These facts support the following conclusions. First, until the growth rate accelerated after 1980, there was no discernible decline in poverty. Second, in the post-reform period after 1991, the slower decline, if not stagnation altogether, of rural poverty is explained in part by the fact that the reform process is yet to be extended to rural areas. Third, because the Group 1 states were endowed with better infrastructure and, above all, with greater human capital as measured by higher literacy rates (particularly among women), lower total fertility rates, and lower infant mortality rates, after the reforms of 1991 the decline in poverty was faster in these states compared with the Group 2 states.

An interesting issue is whether the widening disparities are temporary and reversible or permanent and entrenched. At the aggregate level, one approach to this issue is to ask whether regions with initially different levels of income nonetheless converge in the long run to the same level and rate of growth in income per capita. This is the so-called absolute convergence hypothesis. It is to be contrasted with the conditional convergence hypothesis, which suggests that each region converges to its own long-run level and growth of income per capita. A growing literature tests the hypotheses of absolute and conditional convergence in both China and India. Dayal-Gulati and Husain (2000) find support only for conditional convergence in China. In India, Cashin and Sahay (1996) found evidence of absolute convergence. Rao and Sen (1997) suggest that, in fact, the findings of Cashin and Sahay should be interpreted as supporting conditional convergence. Clearly, a finding of conditional convergence, since it is consistent with regions growing at different rates in the end, could mean growing disparities across regions. In India, there is evidence of growing disparities between the growth rates of the southern and western coastal states, on the one hand, and the interior and northern states, on the other, with the former growing faster in the post-reform era. Coupled with the fact that the incidence of poverty is higher and the share of the country's popu-

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lation larger in the latter states, there has been legitimate concern that, if sustained in the future, these growth disparities will threaten the stability of India's federal democracy.

Summary and Conclusions

There can be no doubt that the eradication of mass poverty, which has always been the overarching objective of development, at least in the rhetoric of national and international policymakers, still remains a challenge. The rhetoric has not changed. If anything, it is reiterated periodically, for example in the Millennium Development Goals of the United Nations and the speeches of the president of the World Bank and the managing director of the IMF. Nevertheless, moving from rhetoric to reality requires an analysis of, and drawing appropriate lessons from, nearly five decades of development experience for both national and international actions.

In my analytical approach, I defined the poor as those who do not have adequate resources at their command to acquire what I called a "poverty bundle of goods and services." I linked this inadequacy both to the inadequacy of assets owned by the poor and to the low return they obtained from the assets they owned. This definition and linking led me to distinguish between two broad approaches to poverty alleviation: redistributing assets (and income from assets) from the rich to the poor and raising the returns to the assets of the poor. I identified policy interventions that are associated with each approach.

The policies associated with the first approach are by definition redistributive. Whether a once-and-for-all redistribution would eradicate poverty, or at least set the poor on a path to overcoming poverty, or would have only a transient effect is not easy to judge. On balance, my judgment was that redistributive policies, even if beneficial in the short and the long run to the poor, are in any case politically difficult to bring about. Most important among the policies associated with the second approach are those policies that have a major influence on the social-economic-political framework in which the poor make their decisions. The economic framework consists of markets and their functioning; aggregate growth; openness to foreign trade, technology, and capital; and macroeconomic stability. I did not discuss the political framework, not because it is not important, but in part because as an economist I am not competent to analyze politics and, more important, because such an analysis can be done meaningfully only with knowledge that I do not have of the domestic political processes of each nation. The analysis of social frameworks requires similar knowledge.

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But I cannot resist registering my serious reservation about the IMF and the World Bank entering the sociopolitical arena by their advocacy of "empowerment" of poor disadvantaged groups, conditioning the resource transfers for poverty reduction on the strategy for such empowerment being arrived at through a "participatory process," and requiring (as in Argentina and Brazil) that, on the eve of an election, the parties in power and in the opposition come to an agreement on the terms proposed by the IMF for its assistance. My reservation is not about the desirability or otherwise of the policies advocated or the terms of assistance. It is about the profoundly undesirable and deep intrusion into the sovereignty of nations. In any case, political solutions imposed by outsiders are unlikely to be sustainable if they do not emerge from domestic political processes. Let me also add that multilateral institutions such as the IMF, the World Bank, and the WTO, each with its own explicit mandate and competence, will fail to serve their constituents if they stray into the mandates of each other. The crossing into each other's mandate by the World Bank and the IMF in the area of poverty alleviation benefits neither institution nor the world's poor.

I argued that the most effective economic framework for poverty eradication is one in which sustained and rapid aggregate growth occurs, the country is open to foreign trade and investment technology, and the macroeconomy is stable. I illustrated this with the experience of the two largest countries of the world, China and India, in the rural areas in which most of the world's poor live. Although policies ostensibly designed for poverty alleviation have existed in India since the 1950s, there was no downward trend in poverty until the economy was opened up (hesitantly in the 1980s and more resolutely after the reforms of 1991) and the growth rate of income per capita doubled. The Chinese experience is even more spectacular: real income growth at unprecedented rates and rapid poverty reduction only after 1978 with the opening of the economy and with markets playing a significant role. I noted that regional disparities in both economies widened in their era of rapid growth. Although I suggested that this widening is in part a reflection of differing initial conditions of different regions when the economy opened up, I left open the possibility that the forces that over time eliminate the initial advantage of some regions may not be strong enough.

I deliberately chose not to discuss the role of external assistance and initiatives such as debt relief and liberal market access provided to a subset of developing countries, some of which are not as poor as some that are left out. I am convinced that the serious challenges to development and poverty alleviation are overwhelmingly in the domestic arena. The contribution of foreign aid, debt relief, and the like is quan-

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titatively significant (relative to GDP or investment) in just a few, small developing countries; and such assistance is unlikely to lift countries out of poverty in the long run. What is far more important is that the world trading and financial system remain open and stable.

I will end on a somber note. The benefits of openness in terms of more rapid growth and poverty alleviation would be considerably reduced if the global trading environment, particularly in rich industrialized countries, became more protectionist. Alas, the hopes created at the November 2001 ministerial meeting of the WTO and the launching of the Doha Round of multilateral trade negotiations are already receding. There is little progress in the negotiations toward liberalizing agricultural trade. Even the Uruguay Round agreement on the abolition of the Multifibre Arrangement (MFA) at the end of 2004—a "concession" that poor countries gained while giving away much in the other components of the round, such as those on intellectual property and investment—is being threatened. The senators from the textile-producing states of the United States are urging a tightening of the MFA quotas, and not their abolition as agreed. If the Doha Round fails to liberalize agricultural trade and the MFA is resurrected, the consequences for the poor and poor countries could be disastrous. Just as I was about to conclude, there was encouraging news that the U.S. administration would propose that all tariffs on industrial and consumer goods, including textiles and apparel, be eliminated by 2005, and some of them even earlier (*New York Times*, 2002). I hope this is a harbinger of more good news.

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6

Promoting Trade: Regional Integration and the Global Economy

F. O. Ndukwe

One of the important characteristics of evolving globalization is the marked increase in world output and trade. Rapid global integration has led to significant economic expansion, notably in industrialized countries, but also in developing countries with outward-oriented economic and trade policies. During the 1990s world output expanded at an average annual rate of 2.9 percent, while trade grew by 6.0 percent. For developing countries as a group, relative to the world as a whole, the rate of output growth was much higher at 5 percent. Asia, as a region, recorded an even higher average annual growth rate of 9 percent. Africa, on the other hand, lagged far behind other regions with a growth rate of about 2.3 percent. With respect to trade, during the same period, the export and import volumes of developing countries grew at a much higher rate than the global average, with several Asian countries recording double-digit growth rates.

It is well known and empirically documented that the rapid expansion in global trade occurred in response to countries' increasing acceptance of openness. Other major contributing factors include the decrease in the unit costs of transport and information technology, including telecommunications; and the globalization of production, with industries moving to areas offering opportunities for lower production cost. The liberalization of global trade has taken many forms, including nondiscriminatory unilateral liberalization, multilateral liberalization, and liberalization in the context of trading blocs (free-trade areas, customs unions, and common markets).

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A marked feature of the distribution of the benefits from globalization and liberalization is that the lion's share has gone to those countries and regions that sustained outward-oriented trade and economic policies. In contrast, just a portion of the gain has accrued to countries with weak performance in reform and tenuous links to the global trading system. However, the rising isolation and marginalization of many countries, mostly in the developing world and particularly in Africa, have also been exacerbated by the protectionist policies in industrial countries. These have erected barriers and have constrained market access to the basic commodities produced by developing countries, thus circumscribing the comparative advantage of these countries in global trade.

With specific regard to the continuing marginalization of Africa in the global economic arena, it is important to highlight the structural rigidities of production and the economic environment that have prevented the continent from taking advantage of globalization. First is the significant shift in the composition of global exports away from basic commodities toward manufactures, clearly an area where Africa does not currently enjoy comparative advantage. Second is the rapidly expanding intrafirm and intra-industry trade—an important indicator of the globalization of production. Here also, since Africa's share in global production has been declining, it has been unable to share in this fast-growing aspect of global trade. Third is the rising share of trade in services, which is expanding even faster than trade in goods. Fourth is the balkanized structure of African markets, notwithstanding the creation and existence of several regional integration arrangements. The establishment of a number of regional economic communities has not led to the creation of large and effective trading blocs with effective, sizeable markets, sufficient to produce scale economies and competition. Last, even though the past decade has witnessed the expansion of worldwide flows of foreign direct investment (FDI), Africa's share in these flows has been minuscule.

The thesis of this paper is that for Africa to end its global isolation and marginalization and become an important beneficiary of the fast-expanding global trade, the continent must implement appropriate economic and institutional reforms, create large and effective markets with links to the global economy, diversify the agricultural base, and engage in value-added processing of primary products. Successfully implementing the NEPAD agenda and strategy for Africa's development will go a long way toward enhancing Africa's global competitiveness and create an environment conducive for growth and poverty reduction.

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Regional Integration in Promoting Trade in Africa

By increasing trade and investment, economic cooperation and regional integration create opportunities to reap the gains from globalization. For Africa, a region characterized by small and balkanized states and markets, economic cooperation and regional integration have the potential to create an expanded and unified market, diversify the economic base, and increase competitiveness in the global market. Open regionalism, with expanding regional trading blocs coexisting alongside the global integration of markets, has spurred growth and development in many parts of the world. This is a phenomenon from which Africa stands to gain.

Over the past four decades, Africa, in an attempt to forge political unity and expand markets, has established several regional economic communities. Today the continent's economic and political blocs range from preferential free trade areas, to customs unions, to monetary unions. The main advantages expected from these organizations fall into two broad categories. First, the political benefits include the following:

- Fostering continental unity and development
- Promoting peace and growth with neighbors, thus reducing the prospects of conflicts among members
- Facilitating and deepening the exchange of information among democratic neighbors
- Strengthening regional security through its stabilization effect.

Second, economic benefits anticipated from African integration institutions include

- Mitigating the economic disadvantages of fragmentation and reducing the attendant constraints on growth and development
- Promoting industrial growth and creating synergy through exploiting the complementarity of the region's economies
- Raising income through innovation and growth
- Promoting growth through increased factor productivity
- Creating trade and avoiding trade diversion.

Driven by the desire to reap these benefits from integration, African leaders and governments have created several regional economic communities and trading blocs. In West Africa, for example, the integration arrangements include the Economic Community of West African States (ECOWAS), comprising 15 countries in the subregion; the West African Economic and Monetary Union (WAEMU), consisting of 8 francophone West African countries with a common currency, the CFA franc; and the Mano River Union, comprising Liberia, Sierra Leone, and The Gambia.

In eastern and southern Africa, the major integration schemes include the Common Market for Eastern and Southern Africa (COMESA), the Southern African Development Community (SADC), and the Indian

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Ocean Commission. In Central Africa, there are the Economic Community of Central African States, the Economic and Monetary Community of Central Africa (CEMAC), the Central African Economic Community (CAEMC), and the Economic Community of the Great Lakes Countries. And in North Africa there is the Arab Maghreb Union (AMU).

In addition to these intergovernmental integration arrangements, there are several activity-based organizations, such as the Cross-Border Initiative, the Club du Sahel, and the Committee for Drought Control in the Sahel. Today many African countries belong to more than one regional integration scheme. However, it is worth noting that several of these integration schemes have duplicate and overlapping mandates and are very poorly funded. Appendix I shows the evolution of these trading arrangements, and Appendix II highlights the degree of overlap in membership in these organizations.

Overview of Achievements

Measured against the anticipated gains, the results of Africa's integration efforts can, at best, be described as mixed. It can be claimed that membership in subregional organizations affords member countries opportunities to cooperate and promote good neighborliness. The Organization of African Unity, recently transformed into the African Union, serves as a forum for African leaders to exchange views on matters of common interest to the continent. The existence and achievements of the ECOWAS Monitoring Group, established to prevent, manage, and resolve conflicts, point to the political benefits that can be realized from cooperation among African countries. There has also been some progress in facilitating the regional mobility of labor, particularly in the ECOWAS subregion, where a common travel document permits nationals of one member country to enter the other member countries without visa requirements. COMESA and CAEMC have also introduced regional passports, which allow nationals of each member country entry into the other countries without visas.

The results have also been mixed in realizing the economic benefits from integration. The assessment of monetary integration efforts is generally positive. Studies of the Communauté Francophone d'Afrique (CFA), for example, Medhora (1997) and Guillaumont, cited in the former, find that the growth performance of its members was better than for the non-francophone zone. Symbolizing deeper integration, the WAEMU subregion's cooperation has extended beyond traditional trade integration to encompass the integration of fiscal, judicial, and monetary management in addition to establishing a functioning compensation trust fund. The zone has also demonstrated some of the benefits and challenges of an

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integration arrangement involving industrial countries. Under the association arrangements, the zone has been receiving assistance through France in the form of institutional capacity development, budgetary support for fiscal control, and monetary management.

There has also been some experience in monetary cooperation in southern Africa. The level of trade and financial transactions conducted with the South African rand points to the potential benefits that could be realized from the existence of an effective rand area within the Southern African Customs Union. Some analysts believe that the existence of, and perceived benefits from, these functioning monetary zones are instrumental in the current drive to establish a second monetary zone in the ECOWAS subregion.

Africa's Share of World Output

Table 6.1 shows that the world economy grew at an average rate of 3.3 percent annually during the 10-year period 1984–93 and is projected to achieve an average growth rate of 3.6 percent during 1993–2003. During these two periods, the industrial economies are projected to grow at about 3 percent, while developing countries will grow at 5 percent. Developing Asia has been the most dynamic of the developing regions; over 1984–93 the region recorded an annual GDP growth rate of 7.6 percent. The region is projected to grow at 6.8 percent a year for the 10-year period 1994–2003. Comparable figures for Africa are 2.0 percent and 3.4 percent, respectively. Africa's average annual growth rate of about 3.2 percent from 1997 to 2001 made it the third most dynamic region in terms of GDP growth, after Asia and the Middle East.

Even though Africa has recovered from a very severe economic contraction during the 1980s, there is still much unused productive capacity. Moreover, to reduce the currently widespread poverty over the next 10 years, Africa must achieve an annual growth rate of about 7 percent if it is to attain the UN Millennium Development Goal of reducing poverty by 50 percent by 2015.

Africa's Trade Performance

Africa's trade performance shows long-term decline in its competitiveness and share in global trade. It is apparent from Table 6.2 that Africa is the only region to have experienced a steady decline in its share of global exports over the period 1985–2000. During this period, the value of the region's exports declined by about 50 percent. Imports also declined, from 2.8 percent of world imports in 1985 to a low of

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Table 6.1. GDP Growth Rates by Region

(Annual percentage changes)

	10-year average											
	1984–1993	1994–2003	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
World	3.3	3.6	3.7	3.6	4.0	4.2	2.8	3.6	4.7	2.5	2.8	4.0
Industrial economies	3.2	2.8	3.4	2.7	3.0	3.4	2.7	3.3	3.9	1.2	1.7	3.0
Developing countries	5.1	5.2	6.7	6.1	6.5	5.8	3.5	3.9	5.7	4.0	4.3	5.5
Regional groups												
Africa	2.0	3.4	2.3	3.0	5.6	3.1	3.4	2.6	3.0	3.7	3.4	4.2
Developing Asia	7.6	6.8	9.6	9.0	8.3	6.6	4.0	6.1	6.7	5.6	5.9	6.4
Middle East	3.4	3.5	0.5	4.2	4.8	5.6	3.9	1.0	5.8	2.1	3.3	4.5
W. Hemisphere	2.9	2.7	5.0	1.8	3.6	5.2	2.3	0.2	4.0	0.7	0.7	3.7

Source: IMF (2002).

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Table 6.2. Africa's Share of World Trade
(In percent)

	Share of World Exports				Share of World Imports			
Region	1985	1990	1996	2000	1985	1990	1996	2000
World	100	100	100	100	100	100	100	100
Africa	3.2	2.3	1.9	1.6	2.8	2.2	1.8	2.0
Asia	15.8	16.9	21.8	18.0	15.4	15.8	22.0	22.1
N. America	15.8	14.9	15.5	23.6	21.5	17.8	19.3	16.6
Europe	38.7	45.7	41.9	42.2	38.3	45.8	38.4	43.8

Sources: UNCTAD (1996/97); IMF (2001); see also footnote 1.

1.8 percent in 1996, rising only marginally to 2 percent in the year 2000. These figures contrast sharply with those posted by other regions. For example, Asia and North America each accounted for nearly a fifth of world exports and imports over the period, while Europe accounted for almost half of total world exports and imports. Between 1997 and 2001, Africa's share in global investment flows also declined by about 44 percent (to $5.3 billion from $9.4 billion). In 1996, Africa's share of total FDI to developing countries was only 2 percent (UNCTAD, 2001). The loss of market share by Africa for its major commodity exports over the last three decades is estimated to have caused annual revenue losses of about $11 billion in 1996 prices (Ng and Yeats, 1996).[1]

Intra-African Trade

Tables 6.3 and 6.4 show average intra-African exports and imports as percentages of world total exports and imports for the period 1996–2001. AMU imports from the WAEMU, for example, averaged about 1.36 percent over the period under consideration, while the WAEMU in turn imports mainly from ECOWAS and the franc zone. Intraregional exports of SADC, ECOWAS, and WAEMU do not differ much from intra-exports.

Constraints on Regional Integration and Intra-African Trade

Several factors limit the size of intra- and inter-African trade. First is a lack of the structural complementarities necessary for trade creation.

[1]The combined 1993 GDP of the 48 sub-Saharan African countries was about $155 billion. Excluding the four major oil-exporting countries—Angola, Congo, Gabon, and Nigeria—total 1993 sub-Saharan African exports of $19.8 billion were approximately one-half those of Thailand and only $4 billion more than those of Israel (Yeats, 1999).

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Table 6.3. Average Annual Intra-African Exports, 1996–2001
(In percent of world total exports)

Importer	AMU	CAEMC	COMESA	ECCAS	ECOWAS	Franc Zone	SADC	WAEMU
AMU	2.73	0.09	0.57	0.11	0.56	0.4	0.05	0.30
CAEMC	0.54	1.69	0.44	2.10	0.57	1.98	0.54	0.29
COMESA	0.66	0.12	5.76	0.76	0.20	0.19	6.36	0.04
ECCAS	0.31	1.01	0.47	1.30	0.34	1.18	0.95	0.17
ECOWAS	0.83	1.33	0.56	1.76	9.63	6.88	1.31	5.55
Franc zone	1.03	1.82	0.59	2.24	8.78	7.08	0.90	5.26
SADC	0.23	0.21	8.39	1.39	0.81	0.46	12.30	0.22
WAEMU	1.70	1.99	0.78	2.44	19.86	13.96	3.82	11.97

Source: Statistics Department, African Development Bank, 2002.

Second, Africa's restricted industrial base offers limited scope for economies of scale in production and marketing. Third, the continent's poor and inadequate infrastructure limits trade and raises the cost of the little merchandise that is eventually traded. This, in part, accounts for the high level of informal trade, which is often confined to the common borders of adjacent countries. Fourth, the absence of compensatory mechanisms discourages trade liberalization reforms because of the fear of losing revenue. Similarly, the multiple and overlapping regional trading arrangements, each with its common external tariff, have hindered rather than enhanced trade. Finally, the small size of the trading blocs severely limits economies of scale. Under such circumstances, imports from outside the bloc, most notably from Europe, are encouraged and preferred.

Table 6.4. Average Annual Intra-African Imports, 1996–2001
(In percent of world total imports)

Exporter	AMU	CAEMC	COMESA	ECCAS	ECOWAS	Franc Zone	SADC	WAEMU
AMU	3.07	0.17	0.58	0.17	0.80	0.60	0.27	0.43
CAEMC	0.91	3.43	0.55	3.65	8.37	6.22	1.94	2.79
COMESA	0.62	0.12	3.49	0.22	0.42	0.26	9.77	0.14
ECCAS	0.57	2.31	2.19	2.55	5.92	4.18	7.92	1.87
ECOWAS	0.81	0.27	0.20	0.28	10.19	4.9	1.31	4.63
Franc Zone	1.19	1.59	0.36	1.68	14.81	7.98	1.52	6.39
SADC	0.05	0.13	3.39	0.37	0.90	0.36	11.00	0.23
WAEMU	1.36	0.57	0.19	0.59	18.55	9.05	1.73	8.47

Source: Statistics Department, African Development Bank, 2002.

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Recent Measures and Initiatives

Whether one uses the traditional measure of trade creation and trade diversion or the now more conventional approach of dynamic gain, the previous section suggests that regional integration arrangements in Africa have not yielded expected results. Several factors, including those identified in the previous section, have combined to inhibit Africa's trade and development, notably among these are the poor macroeconomic environment, inadequate infrastructure services, currency inconvertibility, political instability, poor governance, and weak institutions. Realization of the need to remove these constraints has prompted many African countries to embark on unilateral structural reforms since the mid-1980s. The following paragraphs highlight some of the key features of the trade and nontrade stabilization and structural adjustment operations undertaken by African countries up to the late 1990s. An overview of the findings of an independent assessment of these programs is also provided.

Adjustment Programs

Stabilization and structural adjustment programs. The global recession of the late 1970s and early 1980s severely weakened many African economies. In several countries real GDP growth plummeted, inflation rose to double digits, currencies appreciated, and economic distortions became pervasive. Fluctuations in the global price of petroleum had adverse real and financial impacts on many countries. Mounting external debts also strained the development programs of many governments. Against this background of worsening economic conditions and severe debt overhang, many countries embarked reluctantly on adjustment programs with support from the Bretton Woods institutions. These programs generally aimed at the following reforms:

- Establishing a market-determined exchange rate, mindful of the export competitiveness effects of a misaligned exchange rate mechanism
- Bringing fiscal deficits under control and rationalizing public investment, while directing expenditure to priority areas in health and education
- Improving public debt management
- Improving financial sector policies, which meant restoring positive real interest rates and achieving competitive returns on financial assets, increasing the marginal productivity of capital and boosting the saving rate, and restoring the soundness of the banking sector to improve financial intermediation

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- Improving the efficiency of public enterprises and labor markets to enhance the mobility of goods and labor and to make prices and wages more flexible
- Improving the coverage and quality of social services.

An assessment of the economic impact of these reform programs shows mixed results. Relative to the initial conditions, the supply response is estimated to be generally positive despite the marked country and regional differences. For example, after introducing reforms, the average annual real GDP growth of sub-Saharan Africa rebounded, although from a low base, from 1.9 percent in 1990 to 5.3 percent in 1996. It then stagnated at about 3.2 percent during 1997 and 1998. Since then it has hovered around 2.9 percent, much too low to reduce poverty.

The investment response to adjustment reforms has been generally slow. It remains so in much of sub-Saharan Africa, with the region accounting for less than 1 percent of global FDI and a much lower share of global portfolio investment. The low level of investment, particularly FDI, is telling evidence of Africa's continuing isolation and marginalization. This suggests, first, that adjustment needs to be deepened, with particular attention to investment incentives, and second, that Africa's debt overhang continues to hamstring investment and growth. Evidence points to policy reversals that have created doubts about commitment to reforms. Above all, the continuing political instability in sub-Saharan Africa has increased the perception the region is too risky for investment.

Unilateral trade liberalization. This has been implemented with two central objectives. The first is to eliminate the antiexport bias, including on intra-African trade and to remove physical barriers to trade; and to eliminate economic distortions caused by the trade regime. The second is to reverse the import substitution policies that underpinned the development strategy of sub-Saharan Africa up to the mid-1980s. The measures included removing export barriers, quantitative restrictions, and other nontariff barriers on imports; reducing tariff dispersion through low and relatively uniform tariffs administered in a transparent and evenhanded manner; and establishing neutral treatment of imports and domestic goods. In addition, institutional reforms were carried out, particularly in the pricing and marketing of produce by state marketing boards.

The assessment by the World Bank and other institutions of the impact of these reforms on trade and investment shows mixed results. The general trend was toward more-open trading regimes, with many countries removing both quantitative restrictions and nontariff barriers. Some countries, particularly those engaged in value-added processing of products, achieved some gains in trade with the rest of the world. For example, Mauritius expanded its export of textiles. For several other countries, the gains were very short-lived owing to exchange rate and price fluctuations,

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leading to deterioration in the terms of trade. Furthermore, intra-African trade did not expand because of poor communications links, including inadequate infrastructure, which kept the costs of shipping and other forms of transportation high within Africa. As Mistry (1996) points out, the gains from tariff reductions and the removal of quotas and nontariff barriers went to nonregional trading partners that were better positioned to take advantage of the outward-looking policies of these countries. In addition, many African countries showed greater resistance to reducing tariffs on regional trade because they feared the negative impact on revenue targets.

Privatization and FDI flows. Capital has become increasingly mobile, searching for the best returns globally. However, Africa has not been an important destination for either portfolio investment or FDI, receiving less than 2 percent of the combined global flow of these resources.

As part of their structural adjustment programs, many countries embarked on the privatization of at least some state-owned enterprises. The purpose was to increase private participation in the economy and improve the efficiency of resource allocation in production; to increase government revenues and reduce budget deficits and public debt; and to increase FDI through ownership transfer and, through it, accelerate the inflow of technology and enhance efficiency and productivity in the economy. These in turn were expected to improve export performance and enhance external competitiveness.

It is instructive that many countries viewed their regional integration schemes as vehicles to widen markets and increase opportunities of scale for investors and the FDI inflows they bring with them. In addition, as envisaged by Collier (1991), the effective regional integration schemes could also provide credibility to, and lock in, good economic policies, thus enhancing investor confidence for both beneficiary countries and the pertinent subregion. Thus, the confluence of accelerated privatization and effective economic integration schemes is expected to enhance the inflow of FDI to Africa.

Several factors account for Africa's poor performance as a destination for FDI. Most notably, the reforms have not been deep. The state continues to dominate productive enterprises in African economies. State enterprises in services and production are still prevalent and absorb large amounts of economic resources, crowding out private investment and stifling competition and efficiency.

Efforts to stimulate FDI through privatization of state-owned enterprises and other private investment-stimulating reforms have produced limited positive results for several reasons. First, only a handful of countries have succeeded in privatizing key state-owned enterprises. Major obstacles to privatization include the lack of political will, policy reversals,

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pockets of insecurity (if not in the privatizing country then in nearby countries), and the inoperative conditions of some of the firms. In the end, the level of FDI inflows was disappointing. Another source of the poor investor response could be the perception that existing regional integration schemes were not effective in creating distortion-free regional markets since they were too circumscribed by states and did not represent effective policy–lock-in mechanisms. Empirical estimates of the trade and FDI effects of regional integration show a very tenuous prospect for Africa (Elbadawi and Mwega, 1998). Their analysis points to some positive impact as a result of the unilateral reforms of individual countries. The existence of a common currency in the WAEMU region is said to have slightly improved intraregional trade and to have generated a limited FDI inflow.

Debt relief and the HIPC initiative. Recurrent external shocks, particularly those associated with the volatility of prices for primary products, declining terms of trade for developing countries, and the fluctuating price of petroleum during the past two decades fueled the debt crises in poor developing countries. Other factors contributed, including erratic climatic changes, economic mismanagement, and conflicts in various parts of Africa. The fear of moral hazard also created some initial resistance to debt relief among lenders. The rising negative impact of the debt overhang, which has strongly accentuated poverty in these countries, led to the HIPC initiative for debt relief of poor countries on a case-by-case basis. As a framework, the HIPC initiative was guided by the following principles:

- The need, on a case-by-case basis, to address the totality of a country's debt with a view to reducing it eventually to a sustainable level
- The need for the donor community to commit resources only to countries that have demonstrated a track record on reforms
- Equitable and coordinated burden sharing
- Continued preservation of the financial integrity of the multilateral development banks as preferred creditors
- The need for all new loans to the beneficiary countries to be on concessional terms.

The enhanced HIPC initiative also introduced several new features to facilitate quick delivery of resources. Several African countries have either reached their completion points under the HIPC initiative and have received substantial debt relief (for example, Uganda and Mozambique), or are about to do so. It is widely acknowledged that the initiative has provided substantial relief to qualifying countries.

Nevertheless, many African countries—including those that have actually received debt relief under the HIPC initiative—still face un-

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sustainable debt-service problems. The evolution of the initiative into an enhanced framework entailing additional debt relief is a clear recognition that heavily indebted countries, most of which are in sub-Saharan Africa, are still struggling to meet their external debt-service obligations.

The following factors contribute to the need for the enhanced HIPCs, corresponding more appropriately to continuing acute debt overhang of the relevant countries:

- External shocks, such as a deterioration in the terms of trade and adverse weather conditions
- Civil strife
- Lack of sustained adjustment or implementation of structural reforms
- Lending policies of many creditors, especially the provision of loans at commercial interest rates with short repayment periods
- Lack of prudent debt management policies in debtor countries, driven in part by excessive optimism by creditors and debtors about the prospect of increasing export earnings to build debt-servicing capacity
- Lack of careful management of the currency composition of external debt.

The continuing debt crises underlie other root causes of Africa's marginalization and lack of participation in global trade and investment. Critical among these are impediments to the access of African products to markets in developed countries, the need for more effective regional and multilateral trading arrangements, and the pressing need for regionally coordinated adjustment programs capable of removing constraints on investment and trade.

Africa and Open Regionalism

Many of the regional economic communities established in Africa during the 1970s could be described as closed regional arrangements. Several of these were formed on the model of import-substituting development, with high walls of protection ostensibly making room for local industries to grow and mature. Influenced by the spectacular export and growth performance of a number of other countries, particularly those in Asia that have implemented export-oriented policies, newer regional integration arrangements have more recently embraced openness through low external tariffs, while creating open regional blocs. The European Union is perhaps the best example among industrial countries since it encompasses many large economies and holds the door open for increased membership and further market enlargement.

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The shift to open regionalism is also driven by the realization on the part of many countries that globalization makes individual economies more open to impulses transmitted from the international economy. Although globalization can create opportunities for national economic development, it also makes national policy environments highly susceptible to these external impulses. These can lead to two opposing forces in the world economy—on the one hand, a desire for economic liberalization, with opportunities to participate in global trade and investment; and on the other, a tendency to adopt protection in the face of perceived negative global forces, such as volatile capital flows, displacement of local entrepreneurs, and market dominance.

In these circumstances, regional bloc arrangements can be viewed as a compromise between these two tendencies. Under certain conditions, regional integration can cushion the impact of economic impulses among regions and thus provide opportunities for regional economic and industrial development. Describing this as a return to "inward or self-reliant regionalism" will be misleading. Some experts have described the phenomenon as "desynchronization of business cycles" (Schwab and Smadja, 1995).

With some caveats, the Asia-Pacific Economic Cooperation and the Cross-Border Initiative in eastern and southern Africa can be described as examples of open regionalism. Across the globe, newer regional integration arrangements are increasingly incorporating openness in their charters. Some existing closed regional blocs are amending their charters to take better advantage of global market opportunities. It is envisaged that more and more African countries will embark on and sustain their unilateral economic adjustments, and their regional blocs will adopt lower external tariffs. The continent will thereby enhance its prospects and participation in the global economic system, particularly in trade.

Africa in the Multilateral Trading System

In addition to unilateral actions, there is a pressing need for the multilateral trading system to become equitable and evenhanded. The following paragraphs highlight the strengths and weaknesses of the current multilateral trading system.

WTO: Multilateralism and Regionalism. The World Trade Organization (WTO) was created in 1995 to oversee the General Agreement on Tariffs and Trade (GATT), which had guided rules of international trade since 1947. The GATT's role was to codify and record a series of tariff reductions that its members wished to make, and provide a structure to give credibility to those reductions. A key concept of the GATT, which underpins the present global trading system, is nondiscrimination

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between different sources of the same imported good. This is achieved by requiring members to give each other "most favored nation" treatment, except in specified circumstances. In addition to administering the GATT's rules, the WTO has far-reaching powers. It requires member countries to subscribe to virtually all its rules rather than allowing them to treat some as optional. To be effective, the WTO must proceed by more or less requiring consensus.

The WTO can enhance the economic well-being of developing countries in four ways. First, if enough members wish, it can organize periodic rounds of tariff negotiations (such as Seattle and Doha). These offer opportunities and incentives to reduce their barriers to trade. Second, it provides support for domestic policy, including providing informational support to members in debates over trading laws. Third, it can protect the rights of members against certain violations of the rules by other members (through court decisions and penalties). And fourth, it provides a forum and mechanism for governments to manage the spillovers from members' trade policies onto their partners. These four avenues provide the framework for assessing the WTO's current rules about regional integration arrangements. This framework is spelled out in GATT Article XXIV (for goods). An "enabling clause" introduced in 1979 significantly relaxes the conditions for creating regional integration arrangements that include only developing countries.

Notwithstanding good intentions, the application of GATT–WTO rules has not been evenhanded. While giving notional support to open trade, the industrial countries and their regional trading arrangements maintain restrictive policies that deny access of goods from developing countries. These restrictions prompted Michael Moore, the Director-General of the WTO, to argue at the 2000 United Nations Conference on Trade and Development that richer nations need to bring down trade barriers to exports from developing countries. He said, "It makes no sense to spend extra billions on enhanced debt relief if, at the same time, the ability of poorer countries to achieve debt sustainability is impeded by lack of access for their exports." Echoing similar sentiments in a recent presentation to the WTO, Wiseman Nkuhlu, Chair of the NEPAD Secretariat, reiterated the need for open access for African goods to the markets of industrialized countries, particularly for those agricultural commodities in which the continent has comparative advantage.

Bilateral Initiatives to Promote African Trade

Arising out of concern for the continued marginalization of Africa since the mid-1990s, several multilateral and bilateral initiatives have

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emerged. If exploited, these could enhance the economic growth of the region and contribute to reducing its gaping poverty. Among these are the following:

African Growth and Opportunity Act (AGOA). As part of United States general policy to support Africa's development, AGOA provides duty-free access to U.S. markets for products originating from African countries. A premise of the act is that trade could reduce Africa's aid dependency.

AGOA-based duty-free eligibility is qualified on several conditions. This includes a determination of progress toward establishing a market-based economy, rule of law, and political pluralism; elimination of barriers to U.S. trade and investment; protection of intellectual property; efforts to combat corruption; policies to reduce poverty; increased availability of health care and educational opportunities; protection of human rights and worker rights; and elimination of certain child labor practices.

As of January 2002, 34 African countries had been certified as meeting the criteria to export to the United States free of quotas and duty for several items.

It is too early to measure the impact of AGOA on Africa's access to and participation in global trade, particularly regarding effective access to the U.S. market. It is, however, significant that there is an element of policy lock-in in AGOA since qualifying countries have to meet some reform benchmarks.

The Cotonou Partnership Agreement. A successor to the Lomé Partnership Agreement among African, Caribbean, and Pacific (ACP) states and the European Union was signed in Cotonou, Benin, in 2000. The new agreement covers 77 countries, 48 of which are in Africa, and aims to promote the economic, cultural, and social development of the ACP states with a view to enhancing peace and security and to promoting a stable and democratic political environment. In part, a specific objective of the agreement is to integrate the ACP economies into the world economy, leading to the stimulation of growth and reduction of poverty. The new partnership agreement, the ACP–EU Convention, has four main components:

- Reinforcement of the political dimension of relations between ACP states and the European Union
- Poverty reduction within the context of the objectives and strategies agreed at the international level
- An economic and trade cooperation framework
- Rationalization of financial instruments and a system of "rolling programs."

The new agreement's main objective is to promote the progressive integration of the ACP countries into the global economy by enhancing

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production and the capacity to attract investment and ensuring conformity with WTO rules. The new approach emphasizes trade liberalization, including the adoption of transparent competition policies, the protection of intellectual property rights, and standardization and certification.

The New Partnership for Africa's Development

NEPAD was formulated by African leaders to meet the mounting challenges facing the continent in an era of globalization, whose trade and growth benefits have so far eluded the continent. It comprises a vision for Africa's development, measurable development objectives, and a strategy for attaining these objectives.

Importance of Regional Integration

A guiding principle of NEPAD is the need to accelerate and deepen regional and continental economic cooperation and integration. Referring to the challenges of globalization, the official document launching NEPAD recognizes that "an effectively managed integration presents the best prospect for future economic prosperity and poverty reduction." It asserts: "The integration of national systems of production has made it possible to slice up the value chain in many manufacturing and service-sector production processes. At the same time, the enhanced mobility of capital means that borrowers, whether governments or private entities, must compete with each other for capital in global rather than national markets." NEPAD leaves no doubt about recognition of the opportunities from globalization and the role that regional integration can play in facilitating Africa's ability to convert these opportunities into growth, development, and poverty reduction.

As the initiative evolves from a conceptual debate to programs to implementation, joint action will be needed on Africa's shared problems. Events in one country have implications for its neighbors. Action on the following critical regional imperatives will go a long way in reducing, if not ending, African marginalization:

- Strengthening the mechanisms for conflict prevention
- Promoting and protecting democracy and human rights in member countries and within subregions
- Restoring and maintaining macroeconomic stability, at the country and regional levels
- Establishing transparent legal and regulatory frameworks
- Promoting infrastructure development and common approaches to the provision of regional public goods.

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NEPAD programs provide many opportunities to deepen regional integration and bring dynamic gains from integration. A successful implementation of NEPAD's Market Access Program will ensure that Africa's interests are adequately addressed through the WTO. Furthermore, NEPAD's designation of the subregional integration organizations as focal points for implementing NEPAD programs has laid a solid foundation for market integration. This not only will strengthen regional integration in Africa, but also could well create the groundswell needed to achieve the aspirations of the African Economic Community—the creation of an Africa-wide customs union.

Africa's Recent Integration Efforts and the Way Forward

There is an extensive theoretical and empirical literature on the relationship between globalization and the expansion of world trade. A major conclusion is that free trade matters for growth. Several studies find a positive relationship between free trade and growth during the past two decades (Dollar, 1992; Edwards, 1992; Levine and Renelt, 1992; Barro and Sala-i-Martin, 1995; Sachs and Warner, 1997; and Vamvakidis, 1998).

Although most of the empirical findings are based on evidence from countries that liberalized trade unilaterally, ample evidence also shows that the structure of regional integration arrangements and their relationship with the rest of the world influence the distribution of growth. An unequivocal conclusion is that most developing countries in Africa have been bypassed by the benefits of globalization. Africa's share in global trade and growth has declined since the 1970s, notwithstanding numerous integration schemes. Measured by its share in global output and trade as well as the level of inter-African trade, the continent has made little if any progress.

Several reasons have been put forth to explain Africa's poor trade and growth performance. These include

- The lack of a conducive macroeconomic environment, resulting from poor reform performance
- The structure of Africa's production and the lack of complementarity among its economies
- The absence of political stability
- The small size of regional integration schemes and their inclusion of developing countries only.

This structure of African integration schemes and their concentration on the expected static gains from trade have been identified as a major impediment to the growth of trade and development. This arises from the dominance of primary products in African exports and the in-

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herent and long-standing hub-and-spoke trading arrangements between the continent and its most important trading partner, the European Union. Given the underdevelopment of industry in Africa, the exchange has remained the same—Africa exports primary products and imports finished goods. Consequently, on the basis of the traditional concepts of trade creation and trade diversion, most of Africa's regional integration arrangements cannot generate welfare benefits because the necessary conditions do not exist.

Some Suggestions for the Way Forward

Deepen Economic Integration and Sustain Reforms

To realize dynamic gains, it is argued that integration schemes in Africa must involve deeper integration that will link countries in a mutually beneficial relationship and create a positive synergy from coordinated reforms. In addition to traditional trade integration, this would entail coordinating several policies that have traditionally been viewed as domestic—that is, competition policy, commercial legislation and regulation, investment and tax codes, monetary policy and the creation of a common currency (as exists in the CFA zone), environmental regulation, infrastructure development, labor mobility, product standards, and standards on training and skills certification.

The benefits from regional coordination of reforms in these areas include greater efficiency of resource allocation and production, enhanced prospects for larger investment inflows, technology transfer, and building trust among countries. Several writers (Fine and Yeo, 1997; and Collier and Gunning, 1995) have argued that these benefits are more likely to be realized in an integration arrangement that includes industrial countries because of the prospects for increased investment flow and technology transfer. Above all, it has been argued with cases cited that the former type of trading arrangement is more likely to provide effective restraint, or a policy lock-in mechanism, than the later. It is less clear that industrial countries will be willing to enter into integration arrangements that will confer these anticipated benefits. For their part, developing countries may very well view such arrangements as a backdoor approach to recolonialization.

Evaluate the Structure of Integration Schemes

To the extent that a trading arrangement including industrial countries is founded on strong partnership initiatives—such as NEPAD or a supranational customs union like the African Economic Community—

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there is a chance of mutual benefits to both regions. The current EU approach of entering into multiple bilateral arrangements with countries with varying trading conditions is unlikely to benefit Africa.

Regardless of the polar relationship in an integration arrangement, the literature on regional integration and the need for policy coordination and harmonization has received wide attention. This is because a contradictory policy stance in one member country can negate the expected outcome in another in the absence of effective regional coordination. For instance, as Badiane (1997) observed, in West Africa trade liberalization yielded far poorer outcomes than expected because macroeconomic policy reforms and coordination were not uniformly pursued. A case in point was the revaluation of the Nigerian naira during the early 1990s at about the same time the CFA franc was being devalued. Similarly, Ernest Aryeetey, professor at the University of Ghana, observed that the Ghanaian cedi was allowed to appreciate at about the same time as the CFA franc was being devalued. The importance of a deeper and better-coordinated policy stance, including trade liberalization, can hardly be overemphasized.

Consider Monetary Integration

There is a growing interest in monetary integration in Africa, even though the interest is not widespread and the implications are not thoroughly understood. Although not a common feature of integration arrangements, monetary integration has several advantages as well as drawbacks. As Aryeetey (1998) points out, when coupled with trade integration, monetary integration will contribute to maximizing intraregional flows because the common currency removes the transaction costs implied in using different currencies. It will also economize on the use of foreign exchange by eliminating its use in intraregional trade. Furthermore, a single currency is likely to promote efficiency through the removal of capital controls and introducing price stability with exchange rate stability.

There are, however, inherent risks and costs. Monetary integration is not feasible until there has been a convergence in macroeconomic indicators in the integrating countries. Another disadvantage lies in the loss of the exchange rate as a policy instrument since adjustments can only be undertaken using expenditure-reducing measures. This handicap may be more than offset by the budgetary discipline entailed in monetary integration. The other costs of monetary integration are the loss of the inflation tax and seigniorage and the difficulty in having an autonomous monetary policy. However, if the recent introduction of the euro and the experience of the CFA zone are a guide, monetary integration deserves serious consideration.

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Emphasize Political Stability

The discussion on integration and trade has thus far focused on economic issues and relationships. A necessary condition for regionalization is peace and security or, more generally speaking, stability. Political stability is imperative for a nation's ability to attract and keep investment. Regional stability is essential for transborder investment in infrastructure and telecommunications, which hold the key to industrialization in an era of linked borders and markets. For years, if not decades, African countries have faced internal conflicts that have had severe cross-border spillovers. A region with so many conflicts will not attract FDI away from more stable regions. Thus, if Africa is to stimulate trade and growth, stability must return.

In sum, political and economic factors intertwine in regionalization. The challenge is to adapt African integration arrangements in ways that would stimulate dynamic gains, coordinate and sustain deep reforms, and strive toward stability in member countries and the region.

Role of the African Development Bank in Fostering Regional Integration

The regional integration mandate of the African Development Bank (AfDB) is enshrined in its founding articles, which enjoin the AfDB to promote, individually and collectively, economic cooperation and the regional integration of Africa. In pursuit of this mandate, AfDB has financed several multinational operations over the years, including river basin development, infrastructure construction and maintenance, power generation and distribution, and the development of telecommunications and information technology services. The AfDB has also facilitated the establishment of regional institutions such as the African Capacity Building Facility, Africare, and Afreximbank, to name a few.[2] Furthermore, AfDB has facilitated trade and rural development through its on-lending operations conducted through member countries' commercial and regional development banks.

As part of its institutional restructuring and revitalization, AfDB in 1999 adopted a vision statement that established sustainable growth

[2]The multilateral development banks also promote integration. The World Bank, the Asian Development Bank, and the Inter-American Development Bank have established formal structures to promote integration. For example, the World Bank Africa Region has a formal unit on integration. Among other activities, it has prepared regional assistance strategies to guide the World Bank's regional and country operations in West and Central Africa.

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and poverty reduction as its raison d'être. One of the operational pillars in the vision statement is to facilitate regional integration. In 2000, in an effort to give operational meaning to the vision, AfDB adopted a formal policy on economic cooperation and regional integration. Among other objectives, it identified the global integration of Africa as an overarching objective. To this end, AfDB is accelerating its regional integration efforts through several activities. These include adjustment reforms aimed at creating conducive economic environments in member countries and in the region, facilitating infrastructure development, promoting private sector development, ensuring sustainable development through the mainstreaming of gender issues in its projects and programs, and ensuring the protection of the environment.

In addition to its direct development assistance to member countries, AfDB earmarked 10 percent of its replenishment resources for multinational projects and regional operations to further acceleration of regional integration (seventh and ninth general replenishments of the African Development Fund). A substantial portion of these earmarked resources is being committed to capacity building for regional integration organizations and other institutions, including those engaged in research and private sector development.

The AfDB encourages its member countries to support and promote regional integration; and to do so, it uses performance-based resource allocations. Furthermore, to ensure consistency and harmony in its interventions, AfDB will begin shortly to prepare regional assistance strategies to guide its country-focused interventions, which are articulated in its Country Strategy Papers.

As indicated above, the HIPC initiative has been an important step in strengthening the development capacity of African countries through debt reduction. The resources freed as a result are being directed toward poverty reduction and stimulating growth. It is instructive that AfDB was and remains an active participant in the initiative. As of February 2002, AfDB had committed $1.41 billion in debt relief to 20 African countries.

Finally, AfDB is an active participant in NEPAD. This derives from the vast expertise and development experience that it has built over the years. Recognizing this accumulated expertise and experience, the African heads of state designated AfDB as the initiative's focal adviser on infrastructure development and banking standards under NEPAD. Jointly with the Economic Commission for Africa, AfDB also advises NEPAD in the area of corporate governance. A successful implementation of NEPAD programs in these and other areas will deepen the regional and global integration of Africa.

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Conclusion

In their efforts to overcome the development constraints imposed by the small size of their national economies, African governments have created regional integration schemes. These vary from free trade arrangements to customs unions to common currency zones. Ideally, these schemes should have facilitated integration by creating larger markets with opportunities for economies of scale in production, competition, enhanced investment inflows, and economic growth. The findings of several studies, including this analysis, have shown that integration schemes in Africa have not achieved the expected results. The African economies remain small and not integrated; and in a fast-globalizing world, Africa remains the most isolated and marginalized region.

This chapter suggests that Africa can achieve better integration results and end its global isolation through several measures. Critical among these is the need for consistent implementation of sound macroeconomic policies and the rationalization and transformation of African integration blocs into effective, open, and large markets that will serve as stepping stones for the global integration of Africa. In addition, Africa needs a stable, conflict-free environment if it is to attract and retain investment, particularly FDI, whose global mobility has spurred economic development and growth in other parts of the world during the past two decades. NEPAD's objectives and programs for Africa's development could not have come forward at a better time. The challenge is to transform these programs into actionable development activities and commence their implementation.

Best efforts notwithstanding, Africa will realize little progress toward ending its isolation unless developed countries remove their current trade barriers, which have circumscribed the comparative advantages that African products would have otherwise enjoyed in these markets. There is a pressing need to make the multilateral trading rules, which are currently biased against primary products, more equitable and evenhanded. In this regard, the NEPAD market access program provides a useful agenda with which to promote African trade.

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Appendix I. Inter-Africa Trade, 1990–2001

(In billions of US$)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
						AMU						
Exports to:												
AMU	0.96	1.07	0.96	0.79	0.97	1.11	1.12	0.92	0.88	0.92	1.08	1.20
Africa	1.38	1.46	1.37	1.22	1.36	1.66	1.70	1.55	1.17	1.22	1.46	1.65
World	33.48	32.34	29.98	25.67	25.76	29.18	32.47	34.73	26.93	36.62	48.10	45.57
Imports from:												
AMU	0.80	0.92	1.23	0.99	1.06	1.16	1.16	1.01	0.73	0.96	1.17	1.33
Africa	1.36	1.48	1.76	1.40	1.59	1.82	1.82	1.87	1.28	1.48	1.68	1.92
World	29.77	26.55	28.89	27.96	29.08	34.12	32.36	32.75	32.42	36.16	35.76	37.51
						COMESA						
Exports to:												
COMESA	0.91	0.57	0.63	0.71	0.95	1.04	1.28	1.23	1.18	1.15	1.30	1.33
Africa	1.45	1.22	1.33	1.56	2.06	2.23	2.70	2.63	2.37	2.25	2.61	2.52
World	15.00	15.56	15.35	14.08	16.65	18.00	20.13	19.81	17.53	18.74	27.27	26.10
Imports from:												
COMESA	0.99	0.65	0.78	0.70	1.00	1.07	1.26	1.23	1.20	1.20	1.34	1.38
Africa	2.47	2.32	2.87	2.69	3.38	4.27	4.99	5.13	4.42	4.24	4.83	5.30
World	24.45	21.95	23.30	21.25	23.87	29.62	32.54	32.36	35.52	34.37	40.20	42.90
						ECOWAS						
Exports to:												
ECOWAS	1.56	1.42	2.11	1.78	1.73	1.94	2.29	2.24	2.26	2.38	2.97	2.90
Africa	2.06	1.92	2.50	2.23	2.10	2.50	3.07	3.21	3.21	3.27	4.00	3.83
World	19.63	14.75	20.43	18.49	19.10	21.46	26.96	26.09	22.24	21.76	30.81	29.50

(continued on page 112)

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Appendix I. Inter-Africa Trade. 1990–2001 (*Continued*)
(In billions of US$)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Imports from:												
ECOWAS	1.91	1.43	2.08	1.90	1.83	2.00	2.38	2.21	2.47	2.55	3.14	3.18
Africa	2.18	1.72	2.42	2.23	2.13	2.53	2.82	2.71	2.98	3.22	3.85	3.95
World	17.83	18.39	26.23	22.71	20.82	23.40	23.35	23.00	27.41	24.56	28.04	29.91
					Franc Zone							
Exports to:												
Franc Zone	0.89	0.80	0.71	0.61	0.56	0.77	0.95	1.06	1.11	1.05	1.01	0.98
Africa	1.75	1.46	1.54	1.34	1.30	1.48	1.75	1.74	1.99	1.74	1.83	1.77
World	10.93	10.24	10.20	9.11	9.26	11.07	14.21	14.15	13.33	13.75	16.20	15.40
Imports from:												
Franc Zone	0.90	0.86	0.67	0.57	0.50	0.73	0.89	0.97	1.08	1.09	0.96	1.03
Africa	1.90	1.76	1.68	1.51	1.30	1.81	2.10	2.13	2.13	2.31	2.76	2.81
World	9.63	9.13	10.00	8.50	7.60	10.48	11.76	11.06	12.74	12.52	12.96	14.40
					SADC							
Exports to:												
SADC	1.73	1.80	2.45	2.61	3.09	3.54	1.42	4.80	3.97	4.35	4.60	4.60
Africa	1.89	2.05	2.75	2.92	3.73	4.41	1.70	5.97	4.98	5.46	5.73	5.90
World	26.13	26.78	28.17	26.45	30.00	36.32	13.88	42.88	38.52	37.37	39.36	44.63
Imports from:												
SADC	1.72	1.78	2.44	2.60	3.05	3.47	4.35	4.72	3.87	3.84	4.38	2.51
Africa	2.12	2.07	2.86	2.93	3.56	4.13	5.11	5.42	4.55	4.62	5.27	5.65
World	23.24	23.88	25.96	24.70	28.81	37.62	39.81	38.72	42.42	39.45	41.01	42.60

Source: Statistics Department, African Development Bank.
Notes: AMU = Arab Maghreb Union. COMESA = Common Market for Eastern and Southern Africa. ECOWAS = Economic Community of West African States. SADC = Southern African Development Community.

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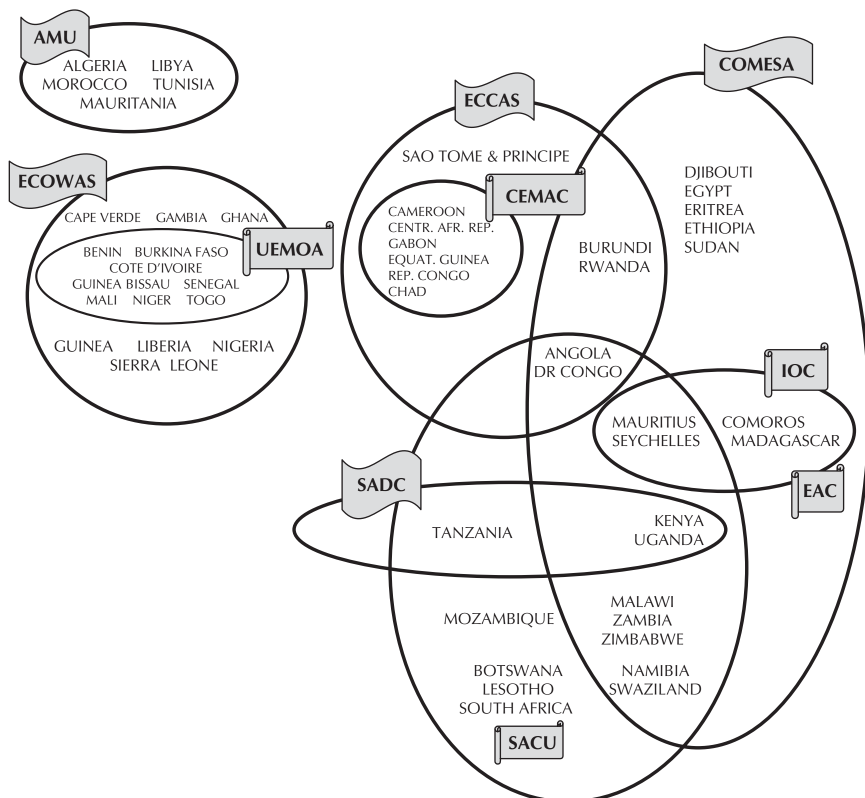
Appendix II. African Regional and Subregional Economic Integration Groupings



Regional and Subregional Groupings

CEMAC: Communauté Economique et Monétaire de l'Afrique Centrale
COMESA: Common Market for Eastern and Southern Africa
EAC: East African Cooperation
ECOWAS: Economic Community of West African States
ECCAS: Economic Community of Central African States
IOC: Indian Ocean Commission
SACU: Southern African Customs Union
SADC: Southern African Development Community
UMOA: Union Economique et Monétaire Ouest Africaine
AMU: Arab Maghreb Union

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7

Policy Reform and Foreign Direct Investment in Africa: Absolute Progress but Relative Decline

ELIZABETH ASIEDU

Foreign direct investment (FDI) in Sub-Saharan Africa increased substantially in the 1990s. However, the rate of increase was meager compared with that in other regions. As shown in Table 7.1, for example, between the 1980s and 1990s, FDI in the region grew by about 218 percent. This compares with an increase of 993 percent for East Asia and the Pacific, 556 percent for Latin America and the Caribbean, 789 percent for South Asia, and 755 percent for all developing countries. As a consequence, Africa's share of FDI to developing countries has declined over time, from about 19 percent in the 1970s to 9 percent in the 1980s and to about 3 percent in the 1990s. This is in spite of the policy reforms implemented by countries in the region. Thus, with regard to FDI, Africa's experience compared with that of other developing countries can be characterized as one of "absolute progress *but* relative decline."

The ineffectiveness of policy reform and the deterioration in Africa's global FDI position are frustrating to policymakers in the region. Indeed, African leaders and the international community have grappled, and continue to grapple, with ways to increase FDI flows to the region. For example, one of the main objectives of the New Partnership for Africa's Development (NEPAD) is to increase Africa's share of global FDI. Also, in March 2002 the United Nations Conference on Trade and Development (UNCTAD) for the first time organized a meeting that brought together policymakers and international business leaders to draw up strategies on how to increase FDI flows to Africa.

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This chapter contributes to this important discussion by examining the underlying factors behind the deterioration of Africa's global FDI position. Drawing on the empirical literature on FDI, the article addresses three questions: Why does Africa's share of FDI continue to decline despite improvements in the policy environment? How can policymakers reverse this trend? And how can Africa attract more FDI in a globally competitive economy?

Finding answers to these questions is important to both policymakers and academics for at least two reasons. First, FDI is crucial to Sub-Saharan Africa. FDI serves as a source of capital, stimulates domestic investment, creates employment, promotes the transfer of technology, and enhances economic growth.[1] The role of FDI as a source of capital has become increasingly important to the region. The reason is that, in order for the continent to achieve its Millennium Development Goal of reducing its poverty rate by half,[2] the region needs to fill an annual resource gap of $64 billion, or about 12 percent of GDP.[3] Since incomes and domestic saving in the region are low, the bulk of the finance will have to come from abroad: from official finance (such as aid from the World Bank) or from private foreign investment. However, official assistance to the region has been declining. For example, net official development assistance (ODA) to Sub-Saharan Africa declined from $17.8 billion in 1995 to $12.2 billion in 2000, a decrease of about 31 percent (World Bank, 2003). Moreover, FDI, including bond finance and portfolio investment, is unavailable to most African countries because of their thin financial markets. In addition, most are unable to raise capital from international capital markets. For example, in 1998 almost all the portfolio investment in the region ($8.6 billion) went to South Africa. From 1995 to 2001, annual FDI flows to Sub-Saharan Africa averaged about $7 billion. This average falls to $2.9 billion when Angola, Nigeria, and South Africa are excluded. (Angola and Nigeria are oil-exporting

[1]See Mody and Murshid (2002) for a discussion on the relationship between FDI and domestic investment, De Mello (1997) for a survey on FDI and economic growth, and Blomstrom and Kokko (1998) for a survey on FDI and technology spillovers to host countries.

[2]The Millennium Declaration was adopted by the United Nations in September 2000. One of the main objectives is to reduce the number of people living in poverty by 50 percent by 2015.

[3]It is estimated that reducing the number of Africans living on less than $1 a day by 50 percent would require a 7 percent annual growth rate. For more on this issue, see the NEPAD declaration document, available at www.avmedia.at/nepad/indexg.

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countries.) Thus, filling the annual resource gap of $64 billion needed for poverty alleviation would require a substantial increase in FDI.

The millennium goal of halving poverty rates is particularly important to sub-Saharan Africa because the poverty rate for the region is very high. About 48 percent of the population lives on less than $1 a day, compared with 4 percent for Eastern and Central Europe, 15 percent for East Asia, 12 percent for Latin America, 2 percent for the Middle East and North Africa, 40 percent for South Asia, and 24 percent for all developing countries. Furthermore, in several countries in the region, more than half the population live in abject poverty. For example, the poverty rate for Burkina Faso is 62 percent, 66 percent for the Central African Republic, 73 percent for Mali, 70 percent for Nigeria, and 64 percent for Zambia. For such countries, the role of FDI as a source of capital is critical. Indeed, the importance of private foreign investment as a source of capital is reflected in the declaration of the NEPAD agreement, which notes that "NEPAD seeks to increase private capital flows to Africa, as an essential component of a sustainable long–term approach to filling the resource gap."

This paper provides a plausible explanation for the deterioration in Africa's global FDI position and proposes policies that will enhance FDI flows to the region. The analysis focuses on three key policy-related variables that affect FDI flows: infrastructure development, openness to trade and investment, and institutional quality. Measures of these variables indicate that Sub-Saharan Africa's policy environment has improved over time—the region has made *absolute progress*. However, compared with other developing countries, policy reform in the region has shown *relative decline*. As a consequence, the region has become increasingly less attractive as other developing countries have become more attractive for FDI. Thus the ineffectiveness of policy reform and the deterioration in Africa's global FDI position may be explained by the fact that sweeping reform in other developing countries and mediocre reform in Africa have made Africa less attractive for FDI.

The following section describes how Sub-Saharan Africa's infrastructure, institutions, and FDI policy have changed over time compared with other regions.

Description of the Variables and Data

According to the "eclectic" theory of FDI, countries that have a locational advantage will attract more FDI (Dunning, 1988). Location-specific advantage covers any characteristic (economic, institutional, or political) that makes a country attractive to FDI. This includes large domestic mar-

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kets, the availability of natural resources, an educated labor force, good infrastructure, low labor costs, and reliable institutions, to mention but a few. The empirical literature on the determinants of FDI to developing countries has generally focused on identifying the location-specific factors and the relevant government policies.[4] As pointed out earlier, the objective of this chapter is to prescribe policies that will improve Sub-Saharan Africa's global (relative) FDI position. It therefore focuses on policy-related variables (variables that can be altered by policymakers) that have been found to have an impact on FDI. It considers three policy variables: openness to foreign investment, infrastructure development, and the institutional setup. The next subsection describes the trends in FDI flows and such variables for Sub-Saharan Africa and other developing countries.

FDI Flows to Developing Countries

Table 7.1 indicates that FDI to Sub-Saharan Africa has increased over time. However, the growth rate is substantially lower than that for developing countries as a whole, causing the region's share of global FDI to decline over time.

Table 7.1. Annual Averages of Net FDI Inflows to Developing Countries and Selected Regions, 1970–99

	FDI Net Inflows (In millions of dollars)			Growth (In percent)	
Region	1970s	1980s	1990s	1970s–80s	1980s–90s
East Asia and Pacific	749	3,967	43,347	430	993
Latin America and Caribbean	2,498	5,714	37,480	129	556
Middle East and North America	129	806	3,836	–725	376
South Asia	61	256	2,278	323	789
Sub-Saharan Africa	773	1,102	3,509	43	218
All developing countries	4,013	12,059	103,075	201	755
Sub-Saharan Africa's share (%)	19	9	3		

Source: World Bank (2003b).

[4]For an extensive survey on the determinants of FDI, see Gastanaga, Nugent, and Pashamova (1998); and Chakrabarti (2001).

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Openness to Foreign Investment

Several studies have found that countries that are open will attract more FDI (Asiedu, 2002; Noorbakhsh, Paloni, and Yousseff, 2001; Morrisset, 2000). In the FDI empirical literature, the most widely used measure of openness is the share of trade in GDP. Thus the positive relationship between trade volumes and FDI implies that countries that wish to attract more FDI should increase their trade. However, as pointed out by Rodriguez and Rodrik (2000), this type of policy recommendation is not constructive because policymakers do not directly control the volume of trade. Since the objective of this chapter is to prescribe policies that will enhance FDI flows to Africa, it considers three measures of openness that can be altered by policymakers. The variables and their sources are described below (data are presented in Table 7.2):

- *Capital controls*. This measures restrictions on capital market transactions. The rating is computed based on the index of capital controls from among 13 IMF categories. It ranges from 0 to 10, with a higher rating implying fewer restrictions.
- *Restrictions on trade and investment*. This is a composite measure of variables that limit trade and investment. It includes taxes on international trade, regulatory trade barriers (tariffs, quotas, license fees), and exchange controls. It ranges from 0 to 10, with a higher rating implying fewer restrictions. Data for this and for capital controls

Table 7.2. Measures of Openness for Selected Regions, 1980–99

	Capital Controls			Restrictions on Trade and Investment			Host Country's Investment Climate		
Region	1980s	1990s	Percent change	1980s	1990s	Percent change	1980s	1990s	Percent change
East Asia and Pacific	3.4	4.9	45.7	6.2	6.6	7.1	6.6	6.3	–4.7
Latin America and Caribbean	2.4	4.1	74.6	3.9	5.6	44.3	4.7	6.4	34.2
Middle East and North Africa	1.7	2.3	35.3	5.0	5.5	10.3	5.8	6.1	3.7
South Asia	0.4	0.6	50.0	3.1	3.6	17.7	5.7	5.4	–3.1
Sub-Saharan Africa	0.6	1.1	76.1	4.9	5.8	18.5	5.1	5.4	6.9
All developing countries	1.2	2.3	86.8	4.1	5.2	30.1	5.1	5.8	13.3

Sources: World Bank (2003) and www.freetheworld.com.

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are published by the Fraser Institute and are available at www.freetheworld.com.

- *Host country investment climate.* This measures the host country's attitude toward inward investment. The rating ranges from 0 to 12 (a higher score implies a better investment climate) and is determined by four components: risk to operations, taxation, repatriation of profits, and labor costs.

The data for all three measures of openness show that Sub-Saharan Africa has become more open in the 1990s. However, the pace of liberalization was slow compared with most other developing countries. For example, with regard to restrictions on trade and investment, the average rating for Sub-Saharan Africa improved by about 19 percent. This compares with an increase of 30 percent for all developing countries.

Infrastructure Development

Good infrastructure facilitates production, reduces operating costs, and thereby promotes FDI (Wheeler and Mody, 1992; Asiedu and Lien, 2004). In the literature, the number of telephone main lines per 1,000 people is often used as a proxy for infrastructure development. This form of measurement has two caveats. First, the data do not include mobile phones. Hence, with the rise in the number of mobile phones, this traditional variable may not be a good proxy for infrastructure. Second, the variable measures only infrastructure *availability* and does not take into account the *reliability* of the infrastructure. To take account of these shortcomings, three other measures of infrastructure development are used here (the data are from World Bank, 2003):

- *Telephones per 1,000 people.* This is the sum of telephone main lines and of mobile phones per 1,000 people. This variable captures the availability of infrastructure.
- *Electric power transmission and distribution losses as a share of output.* This includes losses in transmission between sources of supply and points of distribution. This variable measures the reliability of infrastructure.
- *Gross fixed capital formation as a share of GDP.* This includes land improvements and construction of roads, railways, schools, and industrial and commercial buildings. This variable measures infrastructure development in host countries.

Table 7.3 shows that infrastructure availability in Sub-Saharan Africa, defined as the number of telephones per 1,000 people, improved in the 1990s. However, the rate of increase was less than the rate for all developing countries. From the beginning of the 1980s through the end of

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Table 7.3. Infrastructure Development for Selected Regions, 1980–99

	Gross Fixed Capital Formation (In percent of GDP)			Electric Transmission Losses (In percent of output)			Telephones per 1,000 People		
Region	1980s	1990s	Percent change	1980s	1990s	Percent change	1980s	1990s	Percent change
East Asia and Pacific	25.2	32.6	15.8	8.1	7.6	–6.8	9	51	490
Latin America and Caribbean	20.2	19.3	–4.4	13.1	15.7	19.8	50	109	119
Middle East and North Africa	24.2	21.8	–9.7	10.4	10.9	4.8	27	61	125
South Asia	19.6	21.4	9.3	19.4	19.4	0.1	4	13	228
Sub–Saharan Africa	19.9	17.3	–13.1	8.1	9.6	10.6	8	13	71
All developing countries	23.4	24.0	2.7	10.8	11.7	9.2	21	55	158

Source: World Bank (2003).

the 1990s, the number of telephones per people increased by about 71 percent. This compares with an increase of 490 percent for East Asia and the Pacific and 158 percent for all developing countries. With regard to infrastructure reliability, the data suggest that, as in most developing countries, the quality of infrastructure in Sub-Saharan Africa declined in the 1990s. However, the rate of deterioration was higher in Sub-Saharan Africa. For example, electric transmission losses as a percentage of total output increased by 11 percent in the region, as compared with an increase of about 9 percent for all developing countries. Table 7.3 also shows that countries in the region on average spent less on infrastructure in the 1990s than in the 1980s. Gross fixed capital formation as a share of total output declined by 13 percent over the two decades. This compares with an increase of about 3 percent for all developing countries.

Quality of Institutions

Institutional inefficiency, as measured by corruption, weak enforcement of contracts, and a large bureaucracy, deter foreign investment (Asiedu and Villamil, 2000; Gastanaga, Nugent, and Pashamova, 1998; Campos, Lien, and Pradhan, 1999). For the present analysis, three measures of institutional quality are used in Table 7.4:

- *Corruption*. This variable measures the degree of corruption within the political system. It covers actual or potential corrup-

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tion in the form of nepotism, excessive patronage, and bribery. The ratings range from 0 to 6, with a high rating indicating less corruption.

- *Rule of law.* The variable measures the impartiality of the legal system and the extent to which the rule of law is enforced. The ratings range from 0 to 6, with a high rating implying an impartial court system.
- *Bureaucratic quality.* The ratings range from 0 to 6; a high score implies that the bureaucracy has the strength and expertise to govern without drastic changes in policy and interruptions in government services.

Data for the measures of institutional quality were obtained from the *International Country Risk Guide* (Political Risk Services, 2003). They indicate that, with regard to corruption and bureaucratic quality, Sub-Saharan Africa's institutions deteriorated in the 1990s. In contrast, corruption declined in developing countries as a whole, and the quality of bureaucracy improved. The rule of law strengthened in Sub-Saharan Africa in the 1990s. However, compared with other developing countries, improvements were meager. For example, the extent to which the rule of law is enforced improved by about 11 percent for Sub-Saharan Africa, as compared with 58 percent for the Middle East and North Africa, 76 percent for South Asia, and 29 percent for all developing countries. Thus, despite improvements in institutional quality in the 1990s, Sub-Saharan Africa seemed less attractive (relative to other developing countries) for FDI in the 1990s than in the 1980s.

Table 7.4. Measures of Institutional Quality for Selected Regions, 1980–99

	Corruption			Rule of Law			Bureaucratic Quality		
Region	1980s	1990s	Percent change	1980s	1990s	Percent change	1980s	1990s	Percent change
East Asia and Pacific	3.6	3.6	–0.8	3.5	4.3	24.6	2.4	2.6	6.7
Latin America and Caribbean	2.5	2.9	17.0	2.4	3.1	27.1	1.3	1.7	30.1
Middle East and North Africa	3.0	3.1	2.3	2.4	3.8	57.6	1.9	2.1	11.8
South Asia	1.9	2.5	27.8	1.5	2.6	75.5	1.7	2.0	17.2
Sub-Saharan Africa	2.7	2.7	–2.4	2.5	2.8	10.8	1.5	1.5	–1.6
All developing countries	2.7	2.9	7.3	2.5	3.3	29.1	1.5	1.7	16.1

Source: *International Country Risk Guide.*

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Conclusion

This chapter has provided a plausible explanation for the continuing decline in Africa's global FDI position despite improvements in the policy environment. It has argued that although Sub-Saharan Africa improved its infrastructure, liberalized its investment framework, and reformed its institutions, the degree of reform was mediocre compared with the reform implemented in other developing countries. As a consequence, relative to other regions, Sub-Saharan Africa has become less attractive to FDI over time. With regard to policy, the results indicate that the region needs to keep pace with the rest of the world, the reason being that the world has become more competitive and more integrated. It is therefore not enough just to improve one's policy environment: improvements need to be made in both *absolute* and *relative* terms.

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8

The NEPAD Economic and Corporate Governance Initiative: Building Institutions for Sustainable Development

SOUMANA SAKO

At the summit of the Organization for African Unity held in Lusaka, Zambia, in July 2001, the African heads of state and of government adopted the New Africa Initiative, a merger of the previous Millennium Partnership for the African Recovery Program (MAP) and the OMEGA Plan and the UN Economic Commission for Africa's Compact for African Recovery. In October, the Heads of State Implementation Committee, meeting in Abuja, Nigeria, changed the name of the New Africa Initiative to New Partnership for Africa's Development (NEPAD).

NEPAD presents itself as a collective pledge and determination by Africans and their leaders to eradicate poverty and extricate Africa from "the malaise of underdevelopment and exclusion in a globalizing world." Its ambitions are to set an "agenda for renewal" of the continent and put forward a "new framework for interaction with the rest of the world." The NEPAD initiative clearly recognizes that the "agenda for Africa's renewal must, among other things, pursue the objectives of developing and implementing clear standards of accountability, transparency, and participatory governance; introducing appropriate institutional frameworks to support the implementation of the standards of good political, economic, financial, and corporate governance; and building the capacity of African states to establish and enforce transparent, fair,

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and predictable legal and regulatory frameworks and to maintain law and order." These strategic objectives and priorities clearly point to effective institutions as central to the success of NEPAD, and ultimately, to the overarching goal of sustainable development, poverty reduction, and renewal in Africa.

This paper will, first, summarize the theoretical and historical perspectives on the role of institutions and institution building in economic growth and development. Second, it outlines the institutional requirements underpinning the political, economic, and corporate governance initiative as NEPAD tackles the key institutional and policy constraints facing Africa. And third, through a set of policy questions and issues, it suggests strategic directions for the development of institution-building action plans on the continent.

The Role of Institutions and Institution Building in Economic and Social Development

Definitions

There are several definitions of institutions. Ranis (1989) says "institutions define how people inhabiting a certain land space and having command over given resources decide to organize themselves for economic activity." Others see institutions as "a set of structures, lasting patterns of behaviors and relationships (roles) that are guided and supported by broad societal values, regulated by certain norms of conduct (rules) and made operational by organizations" (Dia, 1996). Masahiko Aoki (2001) proposes a game-theory view, whereby institutions can be categorized as players (the state, judicial courts, associations, and the like), as rules (laws and regulations), or as the equilibrium of the game. North (1991) defines institutions as the "humanly devised constraints that structure political, economic, and social interaction." Institutions have also been defined to refer to "rules, enforcement mechanisms, and organizations" (World Bank, 2002).

Institutions can be formal or informal. Quite often, formal and informal institutions coexist, either in a mutually reinforcing or conflicting manner. Whereas formal institutions are relatively easy and quick to establish or to change, informal institutions are, on the contrary, relatively more difficult to establish and slower to change. Informal institutions can sometimes seriously undermine the effectiveness of formal institutions or even divert or derail their official objectives and functions. Some authors distinguish between institutional arrangements and institutional structure, with the former referring to behavior, norms,

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and rules. Also, dysfunctional institutions may persist over a long span; and even in the face of an institutional disequilibrium, institutional changes may not be easy to effect. For example, Bardham (2001) identifies two main obstacles to institutional reforms—first, the tenacity of vested interests and, second, the size of the collective action problem (free-rider and bargaining issues).

Ruttan and Hayami (1984) quite correctly warn that "the supply of major institutional innovations necessarily involves the mobilization of substantial political resources by political entrepreneurs and innovators. . . . The supply of institutional innovations depends critically on the power structure or balance among vested interests in a society."

The Role of Institutions in Economic and Social Development

Few now question the critical role of institutions, institution building, and institutional reform in economic and social development. Beyond the controversies on the role of the state in the East Asian miracle, there is broad consensus that market-friendly institutions explain not only the growth and development performance of the East Asia region, but also the between-country growth differentials among the East Asian economies. By contrast, the suboptimal economic growth of African countries and, more important still, the economic and financial crises that rocked East Asia at the end of the 1990s (as well as the recent accounting scandals in corporate America) have been blamed on institutional inadequacies, shortcomings, or even sheer institutional deficit or vacuum.

As aptly summed up by Nsouli (2002), "There are three important and interrelated components that are essential to economic development: capacity building, governance, and economic reform. Capacity building—the development of skills and institutions—is critical to sustained economic growth. But acquired skills cannot be exploited fully and institutions cannot be implemented properly without well-functioning institutions." In the same vein, even a market economy needs to be supported by nonmarket institutions in order to perform adequately (Rodrik, 1999). Yet not all institutions or institutional changes are conducive to economic growth and development. So, how to identify and bring about those institutions that promote, or at least are conducive to, economic growth and development? And how to change and reform those institutions that hinder development? In this context, a distinction is often made between the efficiency effects and the distributional consequences of institutions and institutional reforms.

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By general consensus, the relevant development policy questions are no longer whether institutions matter, but which institutions are more efficient and effective for economic and social development, and how to build, reform, and nurture such institutions in a developing country context. In the process of economic reforms, Winiecki (1992) argues that "getting the institutions right is as critical as getting the prices right." According to Lin and Nugent (1995), institutions and economic development interact in a two-way relationship whereby institutions can help accelerate the level and the rate of economic development, whereas the latter may also trigger institutional reforms. As Reynolds (1983) has it, after comparing the development of 40 least-developed countries over a 130-year span, "The single most important explanatory variable is political organization and the administrative competence of government." Anne Krueger (1993) goes even further. She observes that "the adoption of the same economic policies in response to the same (economic) circumstances will have different consequences under a politically strong leadership of a government with a well-functioning bureaucracy capable of carrying out the wishes of the leadership than it will when a weak leadership of a coalition attempts to do the same things in circumstances when bureaucracies believe that they can generate support for opposition to those policies."

The NEPAD initiative clearly assumes that Africa's development will be based on market economies; so it is important to put in place those institutions that are most likely to support market-based development strategies. In this context, Rodrik (1999) proposes five broad categories: property rights, regulatory institutions, institutions for macroeconomic stabilization, institutions for social insurance, and institutions for conflict management.

Property rights. The establishment and enforcement of secure and stable property rights was a key factor behind the economic growth and development of Western countries. Property rights, including intellectual property rights, determine not only ownership, but perhaps more important, control over economic assets. They also determine circumstances under which private property rights can be curbed in the public interest.

A key concern is how to ensure that the state uses its power to enforce contracts and property rights but does not behave in a predatory or confiscatory manner toward the private owners of those rights (Bardham, 2001). Herein lies the philosophical underpinning of the minimalist state: that government is best that governs least.

Regulatory institutions. The need for strong regulatory institutions arises from recognizing the existence of market imperfections and market

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failures. Thus, institutions are needed to lower transaction costs and to mitigate the consequences of imperfect information. According to Rodrik (1999), "the freer the markets, the greater is the burden on the regulatory institutions," and "market freedom requires regulatory vigilance." A strong, efficient, and effective regulatory institutional framework is needed to regulate the conduct of business in goods, services, labor, and asset and financial markets. Effective rules and procedures must be enacted and enforced to promote competition and social responsibility in such critical areas as communications, consumer goods and services, and health, food, and environmental protection.

The effectiveness of regulatory institutions, including central banks, is largely a function of their degree of independence and professionalism. However, regulatory institutions can easily become sources of red tape and economic inefficiency. Moreover, they are vulnerable to principal-agent problems and are thus prone to corruption and collusion with the regulated businesses. Indeed, as Rodrik (1996) says, "Bureaucracies are prone to two problems that are fatal to economic performance: they can be captured by the interests they are supposed to regulate, and they can create extreme red tape discouraging economic activity."

Institutions for macroeconomic policy and public management. Governments can seldom rely on the market to be self-stabilizing. Strong and effective public institutions must develop the capacity to design and implement fiscal and monetary policies that are predictable as well as market- and growth-friendly.

Although effective public administrations must manage taxation and expenditure, it is worth bearing in mind that most democratic constitutions give legislatures the power and authority to levy taxes and approve public expenditure. Also, the role of independent audit agencies can hardly be overstated in ensuring transparent and accountable revenue and expenditure management.

The public bureaucracy needs to develop an adequate institutional and human-resources capacity to effectively and efficiently design, deliver, and evaluate public programs and key social services. Although it is critical for the state to strengthen its capacity in such traditional areas as regulatory, administrative, and technical capacity, it must at the same time pay close attention to building new capabilities to meet the challenges of globalization, to foster citizen participation, and to address intergenerational equity issues underlining the search for sustainable development.

Institutions for social risk insurance. Rodrik argues that social insurance schemes perform a legitimizing function in support of a market economy. Relying solely on market forces can expose a country to large

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economic inequalities and unstable economic outcomes. Social insurance schemes thus contribute to social cohesion and stability. However, proper balance is needed between the redistributive and risk-mitigating functions of the social insurance schemes in order to prevent the latter from inhibiting market development and economic progress in general.

Institutions of conflict management and resolution. Life in a group requires social cooperation to foster mutually beneficial projects and activities. Societies must equip themselves with laws, rules, and regulations. These must be transparent and enforceable through effective, rule-bound enforcement agencies and an independent, clean, and fair judiciary. Also, countries need well-functioning, transparent, and representative systems for accessing and transmitting political power, as well as institutional avenues for expression available to groups and to individuals.

Current Status of Institutions and Institution-Building Efforts in Africa

In the immediate postindependence era, most institution-building efforts consisted of efforts to transplant Western-style institutions to newly independent African countries. To fill the vacuum of skills and trained professionals, governments relied on foreign technical assistance provided by bilateral and multilateral aid agencies, including long-term resident experts and overseas training and study tours. Yet as Lin and Nugent (1995) warned, "Mere transplantations of successful institutions from DCs [developed countries] to LDCs [less-developed countries] is no automatic guarantee of success." As a matter of fact, as Dia (1996) has pointed out, these efforts resulted in an institutional disconnect between the state and civil society, between formal and informal institutions, and between corporate and societal cultures. Among the negative aspects of this disconnect are the privatization of state institutions; the shift of resources and functions to favor client networks; and the substitution of personal loyalty, patrimonial incentives, and management for achievement and merit-based incentive systems.

In many African countries, public institutions quickly turned into oversized patrimonial and predatory organs riddled with corruption, mismanagement, inefficiency, ineffectiveness, and rent-seeking behavior, all the more so since, regardless of ideological bent, the state had a tendency to be all-encompassing. To compound this situation, donor-driven and donor-funded projects further fragmented and weakened the state bureaucracy overall (Sako, 1996). Also, by emphasizing personnel retrenchment and payroll budget cuts at the expense of a comprehensive review of the missions and conditions for enhanced efficiency and

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effectiveness of the public bureaucracies, the first generations of public sector and civil service reforms failed to contribute to the improved effectiveness and enhanced legitimacy of the state.

The end result was—and largely remains—African states struggling to live up to the basic functions of capable statehood but with weak capacity to design, implement, and coordinate development policies. Typically, they are saddled with huge external (and, at times, internal) debt and debt-service burdens. As a result of the double process of economic liberalization and political democratization, the private sector, civil society, and decentralized entities have emerged as new institutional players. More often than not, they directly challenge the legitimacy of the state and its capacity to conduct development policy and regulate the market. Indeed, in critical sectors such as telecommunications, energy, and transport, the rhythm of privatization and economic liberalization has dangerously outpaced the capacity of the state to establish efficient, effective, and credible regulatory agencies. Moreover, in new areas such as the environment and consumer protection, the regulatory vacuum puts future generations at serious risk through health hazards and environmental depletion and degradation. Accelerated globalization and the intrusion of the revolution in information technology have caught many African states unprepared. Consequently, they are finding it difficult and painful to adjust to new systems, processes, and behaviors of political, economic, and social governance.

Despite the brain drain, the absolute supply and sectoral and disciplinary diversity of trained professionals has significantly increased. Nevertheless, a paradox of postindependence Africa is that this has not translated into equivalent increase in the capacity of the state to discharge its basic functions. Moreover, the advent of multiparty democracy in many countries has resulted in the marginalization and de facto sterilization of large numbers of professionals and managers who do not hold membership cards in the ruling majority. To make matters worse, to cut costs or attract nationals for overseas duty, many donors have lured top civil servants to local resident missions or donor-funded projects, thereby reducing the supply of competent staff available for public service assignments.

Although supply and demand factors may help to explain why donors can lure professionals away from the public sector (and accordingly, it can be argued that it is up to African governments to address incentive issues), the net effect is further weakening of public sector capacity by the same donor community that then laments the weaknesses of public administration in Africa. At the level of national economies, the matter is further compounded when donor countries offer incentive packages

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to African engineers, medical staff, computer specialists, researchers, and other professionals, fueling the brain drain. In either case, donor countries are reaping huge, unearned, and untaxed "windfall profits" stemming from positive externalities in an imperfect market of skilled African professionals.

In recent years, both the donor community and African countries have recognized the need to build endogenous institutions and human resources, and that key functions of macroeconomic management and development policy cannot be entrusted to long-term, resident, expatriate experts. Also, efforts to build endogenous capacity should benefit not only the public sector, but civil society and private sector organizations.

Institution Building in the Context of the NEPAD Economic and Corporate Governance Initiative: An Overview

The NEPAD document approved in October 2001 in Abuja by the Heads of State Implementation Committee put forward two sets of initiatives perceived to be "(pre)conditions for sustainable development," namely, the Peace, Security, Democracy, and Political Governance Initiative, and the Economic and Corporate Governance Initiative. As initially formulated, the Economic and Corporate Governance Initiative puts more emphasis on state capacity-building—namely, the key institutions for policymaking, public economic and financial management, and regulatory functions to support private sector–led growth—than on corporate governance. Fortunately, the initiative lists among its priority actions a review of economic and corporate governance practices, with a view to recommending appropriate standards and codes of good practice. At its inaugural summit in Durban, South Africa, in July, the African Union adopted the Declaration on Democracy, Political, Economic, and Corporate Governance. In less general terms than in the Economic and Corporate Governance Initiative, it describes the African agenda in this area.

The declaration gives more prominence to values, behaviors, and practices associated with good economic and corporate governance than to the organizations and structures that may be required at the national, regional, and continental levels to enforce those values and behaviors, including sanctions when these values are seen to have been violated. In fact, the declaration only refers to an African Peer Review Mechanism (APRM) as a set of "institutions and processes, which will guide future peer reviews based on agreed codes and standards of democracy; political, economic, and corporate governance."

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The single most important element in the Durban declaration—which attracted the most attention among donors and civil society groups and controversy within African political circles—is the APRM, especially as regards the political dimensions of good governance. Even though the economic and corporate governance elements of the African Peer Review Mechanism have attracted less media attention, they are nonetheless crucial to sustainable economic growth and development in Africa.

Economic and Corporate Governance

The Durban declaration recognizes that good economic and corporate governance values and practices contribute to economic growth and development through market efficiency and controlling wasteful spending, and through their positive impact on consolidating democracy and encouraging private financial inflows. It identifies the following priority set of norms, codes, and standards:

- A code of good practices on transparency in monetary and financial policies
- A code of good practices on fiscal transparency
- Best practices for budget transparency
- Guidelines for public debt management
- Principles of corporate governance (business ethics)
- International accounting standards
- International standards on auditing
- Core principles for effective banking supervision.

Among the key desirable economic and corporate values that should underpin the APRM, several are particularly important.

Sound macroeconomic and public financial management and accountability. Here the emphasis is on macroeconomic stability, budgetary discipline, fiscal transparency, equity, and efficiency in public revenue mobilization and public resource use.

Integrity of the monetary and financial sector. The declaration recognizes that monetary and financial transparency, independence of the central bank, and effective regulatory and supervisory institutions make for the integrity and transparency of the monetary and financial system.

Sound, effective, and reliable accounting and auditing systems. The declaration envisions the establishment of comprehensive, integrated, and reliable accounting systems, which would provide for, among other things, the independence of the supreme audit institution and the communication of reliable and objective reports to public authorities and the general public.

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Effective corporate governance framework. Among the institutional arrangements intended to ensure transparency, accountability, efficiency, effectiveness, integrity, and fairness, the declaration emphasizes a legal framework protecting property rights as well as the rights and obligations of companies, their boards, managements, shareholders, and other stakeholders; and a regulatory framework for effective supervision and transparent financial disclosure.

The Overarching Importance of Political Governance

Although economic and corporate governance are obviously legitimate areas of concern for sustainable development and poverty reduction, they must be cast within the broader need to build strong and effective institutions of political governance. The declaration reflects this close linkage. Moreover, the African Peer Review Mechanism is grounded in an integrated approach to an integrated set of fundamental political, economic, and corporate governance values to which African countries are called upon to adhere to voluntarily, and to which governments are encouraged to strive to observe within their capacity capabilities. NEPAD posits the following key political governance values as a minimum.

Democratic constitutionalism. While recognizing that cross-country variances stemming from diverse cultural and historical contexts are inevitable, the NEPAD initiative considers that a democratic constitution will contain defining rights—fundamental civil and political rights, such as liberty and security, political participation, and democratic election to and transition from political power; freedom of assembly and association; equality before the law; and equal opportunity. Beyond this statement of conventional, if not universally acknowledged, political and civil rights and liberties, NEPAD suggests that where resources permit, constitutions in Africa should contain provisions pertaining to "economic democracy" or a "welfare state," such as enhanced health care, education, and expansion of employment opportunities.

Fair and open democratic processes. Two institutions are seen as key building blocks of a fair and open democratic process, namely an independent electoral commission and a legal opposition. It is important, however, not to equate democracy with the simple fact of these two institutions. Democratic formalities, without concrete avenues of popular participation and with a large majority of illiterate urban and rural masses, can breed political corruption and political disenfranchisement by the majority of the electorate. Furthermore, a formalistically, democratic process does not necessarily guarantee a democratic outcome. Corrupt

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dictators and a greedy, predatory elite may gain access or cling to political power through a process that has all the visible trappings of a democratic process.

Independent judiciary. The rule of law, as well as the rights, liberties, and freedoms of the individual, require an independent, strong, and courageous judiciary that is protected from executive branch interference by the constitutional separation of powers. A key issue is the justification of the principle of *nemo censetur ignorare legum* ("no one is considered ignorant of the law") when the majority of the citizenry is illiterate, written codes are not up to date or are insufficient, a readily available supply of and the access to defense lawyers is not universal, and the geographical reach of the formal judicial system is limited to the capital city and a few urban centers.

Free and independent media. A free, independent, and responsible media fosters transparency in the management of public affairs and public resources, keeping in check governmental excesses, corruption, and mismanagement; empowering people; and providing independent information. In many African countries, however, equal access of political groups and opinions to the official media remains unresolved. Given their legal status as civil servants, the staff of the official media are under pressure politically to apply more or less subtle forms of censorship and self-censorship to protect the "official line." The private media are often dependent on powerful business and political interests, compromising their independence, professionalism, and potential to contribute to policy debate and give voice to citizens.

Civil society. The NEPAD initiative acknowledges the role and contribution of civil society in the democratic process and as a force for socioeconomic development and transparency, responsiveness, and accountability in the management of public affairs. However, NEPAD challenges African civil society to live up to the same high moral and political standards as those expected from governments.

African countries must develop institutional mechanisms to foster and nurture a spirit and practice of partnerships and constructive, mutual engagement between the state and civil society. These partnerships should recognize the state's ultimate and legitimate privilege to decide matters in the national interest, whereas civil society expresses organized yet segmented interests of particular groups in the policy arena or in access to public services and donor resources.

Institutional capacity. The NEPAD initiative identifies capacity deficits—and implementation capacity deficits in particular—as a common factor explaining unsatisfactory governance across Africa. It calls, therefore, for capacity building as a key priority for sustainable devel-

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opment. At stake, first and foremost, is the capacity deficit of the public sector to design sound and responsive public policies and programs and to implement them in an efficient, effective, equitable, and transparent manner. Equitable access to public services remains a key issue where privileged social groups, most of which may be evading taxation, nonetheless enjoy preferential access to government resources.

As demonstrated in Southeast Asia, it is also important to insulate the public bureaucracy from political interference, especially in the context of nascent multiparty political systems. In particular, every effort should be made to shield economic management from the deleterious impact of political patronage and clientelism. Yet, as Dia (1996) observes, "Bureaucratic insulation can be a double-edged sword. Hence the crucial need for control mechanisms to nurture accountability, competence, and honesty and to prevent bureaucrats from becoming a law unto themselves." Dia emphasizes competitive merit-based recruitment and promotion, competitive compensation packages, and security of tenure for high-level bureaucratic officials as means for preventing political intrusion in the management of state bureaucracy. The importance of developing, nurturing, motivating, and protecting a cadre of honest, competent, committed, and unselfish professionals can hardly be overstated if the best-designed institutions are not to become empty shells at best, or a huge drag on limited economic resources that undermines the state's capacity and legitimacy.

A lingering question concerns whether the APRM provides NEPAD with an adequate, if any, enforcement mandate and the capacity to ensure that African countries live up to the norms and codes of behavior underpinning the Declaration on Political, Economic, and Corporate Governance.

Questions and Conclusions

This paper seeks to stimulate debate and guide reflection on the way forward. It does not draw formal conclusions or propose ready-made, one-size-fits-all answers and solutions. Rather, it seeks to raise a few critical questions for policymakers and other key stakeholders as Africa equips itself with the institutional capacity to implement NEPAD and tackle poverty.

- While mindful of the need for formal state institutions to take into account traditional values and codes of behavior, how do we also ensure that decentralization does not lead to the resurgence of traditional, feudalistic power relationships, especially in the rural areas where the majority of the people live?

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- How do we reconcile the need for a professional, public bureaucracy to be independent of political interference and the accountability and responsiveness requirements of a democratic system? What type of incentive systems, performance measurements, and recruitment policy should be put in place?
- How can the advances in information technology influence the management of public affairs in Africa?
- How do we deal with financial liberalization in the context of capital flight and macroeconomic volatility?
- Do we accord priority to the money or the stock market in financial sector development?
- Is there tension or convergence between the objective of freedom of the press and individual rights?
- How best can we improve financial intermediation?
- How best to tackle the "institutional disconnect" in Africa and promote institutional reconciliation—through eradicating informal institutions or by making formal institutions informal?
- How do we build strong regulatory institutions that do not at the same time stifle private initiative and economic growth?
- How do we control brain drain in a globalizing world in order to retain and motivate the most talented economic and public managers?
- How do we ensure the independence of the judiciary in a culture where the head of state or of government is perceived and expected to bear ultimate responsibility for social peace and justice?
- How do we enforce property rights in contexts where oral traditions outweigh, and conflict with, written norms, laws, and contracts?
- How do we generate or improve dialogue between the state and civil society when the latter is perceived to be engaged in unfair, unspoken competition for political power?
- How do we handle the principal-agent problem and fight and control bureaucratic and political corruption in a context of low salaries?
- How do we promote competition where markets are relatively small?
- How do we reconcile the democratic need to enlarge participation in setting the policy agenda and participation in the policy debate, design, formulation, implementation, and monitoring?
- How do we reconcile the need to build and utilize national capacity for the sake of country ownership of the development process, with the need to open up public institutions to external inputs in an increasingly globalized world?
- How do we reinforce the capacity of the state to coordinate the formulation and implementation of development policies in the face of lopsided budgetary dependence on external donors?

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- How do we strengthen the financial regulatory role of central banks and their capacity for supervision and ability to serve as lenders of last resort?
- How do we strengthen the regulatory and enforcement capacity of the state, especially in regard to corporate governance values and codes of conduct in situations where privatization has brought in large, powerful multinational corporations?
- How do we enhance the autonomy of the tax authority?
- Where plundering the state or illegal economic transactions are among the primary sources of personal wealth, how do we prevent predatory segments of the elite from taking control of the state through formal democratic processes?
- Is moving public audit agencies from the executive branch to reporting to the legislature a solution to the problem of independence of public audit agencies?
- How can African governments best equip themselves to conduct and manage the sequencing of economic and political reforms?
- How will the Peer Review Mechanism balance supranational enforcement authority and resources vis-à-vis national sovereignty?
- What adjustments, if any, need to be made to electoral codes and political practices in a context of mass illiteracy?
- What institutional values are needed to bridge the gaps between policy analysis, policy formulation, and policy implementation?
- What is the proper balance between the role of the state and the role of the market?
- What type of formal educational system is needed to supply not only the professional skills that are necessary for economic management, but also the ethics, standard behaviors, and value orientations that are required for the effective running of a market-friendly public bureaucracy?
- What priority should be given to strengthening the capacity for tax collection and expenditure management administration or to upgrading the capacity of the public finance audit and control agencies?
- Who are the political entrepreneurs and innovators in Africa, what are their defining characteristics, and how do we nurture and support them?

This list of questions is by no means exhaustive. But it is hoped that a fruitful debate on these and other questions will help the African people and their development partners to identify key institutional policy and design issues and pave the way for affirmative reform. Africa, and only Africa, can and should make the choices at the dawn of this 21st

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century—in a spirit of true and mutually rewarding partnership with the development community.

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9

The Role of Regional Institutions in Achieving NEPAD's Goals

Charles Konan Banny

Let me start by touching upon a number of salient features of NEPAD, which the African authorities have identified as crucial for jointly addressing the growing underdevelopment of Africa. Next, I want to share what I view as the main reasons for having the regional integration institutions serve as the cornerstone of NEPAD. Finally, in light of the experience gained by the Central Bank of West African States (BCEAO), I shall suggest ways in which these regional institutions may best contribute to fulfilling the goals of this new strategic approach toward achieving sustainable development in Africa.

To begin, in what specific way does NEPAD justify the hopes that have been placed in this new initiative? Historically, Africa's relationships with the rest of the world have not been based on mutual interests and goals. The first new feature of NEPAD is that it establishes a partnership that differs markedly from past relations. NEPAD is predicated on recognition of mutually shared benefits of development in Africa. The rest of the world has good reason to support our development efforts because Africa has substantial growth potential and immense resources. When solvent, our continent's internal market will offer outlets for foreign products. For the same reason, Africa is setting the stage for more rapid social and economic growth and thereby laying claim to a more prominent role on the international political and economic scene. Our goal is to move away from the traditional pattern of cooperation, which relied chiefly on the generosity of bilateral partners at the expense of a clear definition of common objectives. Accordingly, the

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new NEPAD partnership departs from the humanitarian approach to cooperation and instead favors an increased degree of stakeholder accountability with a view to mutually beneficial results. NEPAD cannot attain its fundamental goals unless each stakeholder in the new partnership feels accountable for achieving results that can be measured against clearly defined criteria.

The second distinctive feature of NEPAD is a clean break from existing development strategies. Efforts were made in the latter half of the 1980s to pursue the economic rehabilitation of Africa through structural adjustment programs, special donor assistance programs, and debt relief measures. Still, at the onset of the third millennium, one of the greatest challenges facing African countries and their foreign partners is how to accelerate growth and reduce poverty in Africa.

Significantly, the development strategy promoted by NEPAD reflects a long-term, market-oriented approach focused on the structural reform of Africa's economies. It encompasses a new conception of the state's role, based on increasing ownership of development projects and programs, as well as promotion of the private sector; and it stresses the importance of enhancing the quality of economic policies. A dozen sectors identified as holding the key to sustainable development in Africa will participate in this strategy.

Why should regional integration institutions serve as the cornerstone of NEPAD? In my view, the first argument in favor of this strategy resides in our new approach to development, reflecting our ongoing commitment to integrating African countries into the world economy by expediting regional integration.

Indeed, in its conceptual framework, NEPAD is moored to three successive anchors—national, regional, and the continent-wide. It follows that the NEPAD initiative cannot be operational at the top two levels of the pyramid unless it has been properly implemented at the national level. This is especially vital in the priority areas of infrastructure development, as well as in building human capacities, achieving good governance, fighting corruption, and, in particular, promoting peace and democracy. Furthermore, we must revitalize the partnership between the public and private sectors at the national level, and we need to redefine the role of the state with a view to ensuring the rehabilitation and stability of the business environment.

I see a second reason for basing NEPAD's implementation on regional integration institutions. The quest for economies of scale, increased intra-African trade, and the greater stability provided by the integration process argue in favor of such an approach in a globalized environment. Furthermore, in recent years a global consensus has emerged regarding the need for

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a full-scale review of the international cooperation strategy, with a new focus on regional institutions. In its latest incarnation, which places greater reliance on rapid regional integration, this strategy has focused on maximizing country ownership of development programs and projects.

A third rationale is the need for effective assessment and monitoring of NEPAD's implementation. I believe that the initiative will succeed to the degree that the primary stakeholders can exercise self-discipline as well as mutual supervision of macroeconomic policy in the context of clearly codified mechanisms accepted by all. Peer review of performance and policies will help identify, assess, and disseminate best practices; track progress achieved in the attainment of objectives; encourage governments to abide by agreed-upon rules, principles, and codes; and identify institutional constraints that must be rectified if the goals of NEPAD are to be achieved.

As befits their supranational status, regional integration institutions are by definition better suited to perform this function with the necessary speed and efficiency. Furthermore, the BCEAO experience sheds light on the vital issue of how best to design a framework for peer review of policies implemented in a continent-wide context.

If, as I have just indicated, the regional integration institutions should serve as the cornerstone of NEPAD, how can these institutions best help to fulfill the goals of this new philosophy of African development? To answer this important question, I shall illustrate by discussing BCEAO's experience with regional cooperation in a key area, namely, currency as a common public good.

For roughly 40 years, BCEAO has been conducting a common monetary policy among the member countries of the West African Monetary Union (WAMU). In addition, BCEAO manages the banking system and exercises banking supervision through a uniform banking law, a common prudential framework, and a regional banking commission. The BCEAO also ensures the observance of collective regulations governing the external financial relations of member countries. The BCEAO thus plays a decisive role in strengthening monetary integration and financial stability within WAMU, particularly by enhancing the quality of financial information and monitoring banking risks. In this connection, BCEAO has made a vital contribution to the preparation of a uniform system of accounts for banks and the adoption of legislation to combat money laundering and the financing of terrorist activities.

Within its sphere of competence, BCEAO provides multilateral surveillance for all member countries. This has allowed BCEAO to instill effective monetary discipline, reinforced by constant yet amicable peer pressure in the conduct of monetary policy. This overall framework has

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yielded impressive results, particularly as regards the inflation rate (which averaged 4.1 percent a year over the period 1980–93). Furthermore, following the change in currency parity in 1994, when prices rose an extraordinary 30.7 percent, the efficient exercise of collective discipline helped bring price behavior back to its long-term pathway as early as 1996. The inflation rate thus averaged 2.7 percent a year between 1996 and 2001. This performance has largely been the result of the quarterly monetary reviews of the zone by the finance ministers of the union, as well as the quality of the regional supervision provided by the regional central bank, coupled with amicable peer pressure. The peer pressure has been consistent and realistic, but also firm.

However, in 1994, in view of the difficulties that the member countries experienced in strengthening the economic fundamentals of their common currency, action was taken to broaden the scope of the common currency policy to encompass the whole economy. This led to the establishment of the West African Economic and Monetary Union (WAEMU), whose aim is to expedite economic growth and enhance regional development. The need to ensure the viability of the WAEMU area prompted a decision to make the convergence of economic policies and performance a priority. Accordingly, a mechanism for the multilateral surveillance of macroeconomic policies and performance was established in 1996, supported by a convergence, stability, growth, and solidarity pact, which took effect on January 1, 2000. Notwithstanding the domestic and external shocks that have assailed the WAEMU economies, encouraging progress has been made in the first three years of the mechanism's implementation. The WAEMU countries need to press ahead with this convergence process, enhance macroeconomic stability, and bolster the regional integration that currently holds the key to NEPAD's success.

The lessons I would like to draw from this brief but immensely enlightening period in our history fall into five major categories:

- The sense of shared destiny and partnership afforded by the community-based framework, which rallies member countries around specific, well-targeted objectives that can be easily monitored
- The existence of mechanisms to ensure regular dialogue among government officials and the representatives of community-wide institutions, which allows for continual fine-tuning
- The awareness of a set of rules freely agreed upon
- The strict observance of the cardinal rule of solidarity and equality of treatment among the member countries, which gives the WAEMU its cohesiveness; and, last but not least

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- The indirect pressure that possible sanction by the market exerts upon the conduct of economic policy, even if the available penalties are not imposed.

The experience acquired over time by regional integration institutions, accustomed to managing common public goods in various countries, has a critical role to play in ensuring the fulfillment of NEPAD's objectives. Integration is now a fact of life. This initiative is thus a worthy one; it is based on consensus, and it is timely because Africa, with its vast untapped resources, is genuinely committed to overcoming economic stagnation and contributing to the common good by participating in the market globalization process.

If they are to make a decisive contribution to the development of NEPAD, regional integration institutions must strengthen their institutional framework and enhance their freedom of initiative and their autonomy—in short, their independence—which will be duly reflected in good governance and the accountability of their leadership.

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10

What the IMF Can Do to Support NEPAD

Abdoulaye Bio-Tchané

We have already found one concrete way for the IMF to support NEPAD: bring together the people who will make it work—the politicians and officials who can encourage, design, and implement open, poverty-reducing, growth-oriented, and equitable policies—with the technicians who can provide advice, research the evidence, and help to monitor the processes. The discussions in this seminar are also showing what NEPAD can achieve: sharing of ideas; honest appraisal of goals, approaches, and relative successes; and a calling to account for past promises and aspirations.

I should like to add another introductory thought. There is a critical issue that pervades the philosophy and approach of NEPAD. Yet because it is seemingly neither an economic nor a specifically mandated "IMF issue," none of our seminar sessions addresses it specifically. Nevertheless, it crucially affects every topic that we are covering, and each of our topics has the potential to influence it enormously. I am talking about conflict—*violent conflict* within or between nations. In addition to taking or ruining thousands or even millions of lives, such conflict can set back economic progress for years if not decades.

Alongside the scourge of HIV/AIDS, the saddest fact of the past decade in Africa has been our self-imposed self-destruction. At the turn of the millennium, even after ridding ourselves of apartheid and immediate aftermaths of colonialism, roughly one-third of our nations in sub-Saharan Africa were in conflict. What is more, even after the deactivation of the "frontline states" against South Africa, the conflicts

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were becoming increasingly regional in nature. We saw border issues flare up again as neighbors were sucked into disputes by unsettled rivalries, cross-border incursions, the temptation to grab the spoils of war, or a desire to help related ethnic groups. With this enlargement of the scope of the conflicts came greater actual and potential economic destruction. And with more nations experiencing war, the future risks of war grew. Economic development and physical and human capital, painfully established over the years, were set back a decade or more. Natural resources were plundered. In some countries, a whole generation has now been denied the education and health services so vital to future growth.

Thankfully, the past two years have seen the winding down of many of these conflicts. Indeed, one of the redeeming features of intercountry conflicts compared with civil disputes is that the path to settlement can often be much more straightforward and complete. But there are many areas where unrest is still at or just below the surface. And when it boils over, all the efforts we expend on the NEPAD economic priorities of poverty alleviation, macroeconomic stability, increased transparency, and larger inward resource flows are utterly wasted.

Of course, NEPAD itself will play a crucial role in seeking to prevent or reduce conflict as it occurs. This has always been a major objective of its intended political, governance, and peer review processes. But we also know only too well that the seeds of many domestic conflicts are sown long before they actually flare up. Economic failure and inequality provide fertile ground for social, ethnic, and religious divisions to erupt into violent competition and conflict. On the other hand, economic integration and inclusion, fairly established, can help to overcome the effects of centuries of war and oppression, as the example of Western Europe shows. So I see the objectives of NEPAD for economic growth, poverty alleviation, and regional integration as means for reducing the risks of future conflicts. Gains in overall income and reductions in inequality will help reduce the desperation of the dispossessed, give the vast majority of the population a stake in the protection of resources, and provide the resources to safeguard the state from easy takeover.

How can the IMF help NEPAD meet its objectives of growth, self-reliance, poverty alleviation, and regional integration, which together should lay the ground for regional peace and security? I would like to structure my remarks by distinguishing three themes that seem to underlie the objectives and mechanisms for achieving the economic elements of the NEPAD agenda:

- Describing or formulating guidelines for national economic policies
- Facilitating regional—and ultimately pan-African—integration
- Establishing a peer review mechanism.

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Within each of these themes, I shall suggest very specific roles that the IMF could and should play and some general principles that NEPAD might pursue.

First, on national economic policies, let me address the topic that is at the center of our concerns in Africa—poverty alleviation. I believe that the formulation of national economic policy in Africa has been transformed in the last three years by the advent of Poverty Reduction Strategy Papers (PRSPs). To be successful, PRSPs must be participatory, home-grown, and home-owned. NEPAD need look no further than PRSPs and the PRSP process for the building blocks from which national priorities and processes can be formalized and, ultimately, monitored. Nevertheless, there continues to be a role for the IMF in assisting countries to specify the medium-term economic framework or frameworks that structure the PRSPs, and in formulating policies—macroeconomic, structural, and financial—that can make it viable and growth-friendly. Indeed, the advent of the PRSPs and of the Poverty Reduction and Growth Facility has helped transform the contribution and perception of the IMF in Africa. As President Benjamin Mkapa of Tanzania recently said, "Unlike in the past, the relationship between the IMF and African countries is presently characterized by unprecedented—repeat, unprecedented—mutual respect [and] flexibility."

Looking more specifically at the national economic policies that will underpin a successful poverty reduction strategy, I would identify four areas in which the IMF can offer continuing help—macroeconomic policies; producing a supportive environment for the private sector; ensuring efficient, fair, and transparent management of public revenue and expenditure; and mobilizing international resources, public and private.

The macroeconomic policy side speaks for itself. No poverty reduction program will succeed without macroeconomic stability. The well-tested analysis and advice provided by the IMF through its Article IV consultations, country programs, and multilateral surveillance provide a natural starting point both for the PRSP and for any serious study of the appropriateness of a country's stance with respect to fiscal or monetary policy, exchange rate mechanisms, or external trade policy.

But I would like to emphasize the role that NEPAD could play to support the World Trade Organization (WTO), the IMF, and other international bodies in securing firm and fair liberalization of world trade. For our part, we know that we have to do more to convince the industrial countries to open their markets to Africa and to refrain from the agricultural subsidies and other domestic policy distortions that deprive developing nations of a fair playing field. Indeed, the IMF recently made clear its concerns about policy developments in this area in both the

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United States and the European Union. But we also need to work together to persuade African nations—for their own good—to open up their own markets and to fight the vested interests that seek protection and economic rents for themselves at the cost of choice for consumers and innovation for their economies.

Similar arguments apply to the liberalization of domestic markets and to structural reform. Too often, fear and vested interests hold back progress. NEPAD, supported by the international financial institutions (IFIs), can help countries move forward together in providing an environment of free competition and efficient taxation that will support private sector growth and innovation.

For countries to maintain macroeconomic stability, to ensure fair and efficient allocation of public revenue and resources, and to promote and maintain free markets demands considerable expertise and capacity. So, increasingly, IMF and other IFIs have focused on technical assistance and capacity building. Our latest contribution is the establishment of Regional Technical Assistance Centers, or AFRITACs, the first of which I was proud to help open in Dar es Salaam, Tanzania, in October. These will be steppingstones toward the self-reliance that is a central feature of NEPAD.

The five planned AFRITACs will provide and channel IMF technical assistance and capacity building in a number of areas. But I should emphasize, in a NEPAD context, the central role of their support for public revenue and expenditure management. I believe this will be critical to the attainment of NEPAD's aspirations on governance and poverty reduction. Too often in the past, African countries have seen their revenues plundered or wasted because of corrupt or incompetently managed public spending mechanisms. The IMF's Code of Good Practices on Fiscal Transparency provides a template for the open and rational prioritization of public expenditures; and the IMF's technical assistance can help countries maintain control over the delivery and monitoring of such expenditures and ensure proper accountability. Efficient and fair government lies at the heart of successful economies and is a sure protection against abuse and conflict. More generally, my experience in observing success and failure among economies in Africa—along with the evidence of recent academic work—tells me that institutions matter. The rule of law, property rights, a fair and just legal system, and other measures make all the difference as economies strive for growth and poverty alleviation.

Lastly, in looking at how the IMF can help NEPAD establish guidelines for national economic policy, I should like to touch on resource mobilization. In the long run, private resources will provide the means

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to durable growth. And the best routes to encourage private inflows in a sustainable manner lie through stability-oriented macroeconomic policies, market-friendly structural policies, and good governance, stimulated by investor awareness and involvement exercises such as the recent establishment, with IMF and World Bank support, of investor councils in Ghana, Senegal, and Tanzania.

In the short run, many of our countries will remain highly dependent on financial assistance from donors and international agencies, whose support in turn depends on the performance of recipient countries in IMF-supported programs or in IMF assessments. It is therefore very important that NEPAD guidelines and the policies supported under IMF programs are consistent and mutually supportive. The PRSPs provide an ideal mechanism for bringing this about.

Turning now to the second theme for potential IMF support for NEPAD—regional integration. My own experience from the side of the West African Economic and Monetary Union (WAEMU) is of the invaluable support to the integration process provided by the IMF. Indeed, the establishment of both a common external tariff in WAEMU and the machinery for regional surveillance in WAEMU—including macroeconomic convergence indicators—has relied greatly on IMF advice, technical assistance, and encouragement. The IMF has also provided sustained support to the Central African Economic and Monetary Community (CAEMC) and analytical expertise to the Economic Community of West African States (ECOWAS).

Eastern and southern Africa, however, lack the history of a shared currency, so regional integration is less far advanced. But the IMF is enthusiastically exploring with the Southern African Development Community (SADC)—and potentially with the Common Market for Eastern and Southern Africa and the East African Community—arrangements to coordinate economic policies and achieve convergence on policies to maintain macroeconomic stability. They are also discussing the establishment of free trade and putting in place other policies to encourage integration—for example, the harmonization of standards, procedures, and policies in the fiscal, financial, and statistical areas.

There are nevertheless many unanswered questions on how to realize the visions of the Abuja Treaty and of the African Union, which look to the Regional Economic Communities (RECs) as the building blocks toward full integration across the continent. Clearly, close cooperation will be needed on policies among the RECs, particularly where their memberships overlap, and NEPAD might provide an effective framework for this. The IMF and other IFIs should also be able to

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play an invaluable role here in providing advice on ways to establish consistency, both between the policies of different RECs and between country programs and the RECs of which they are members.

My third theme is perhaps the most difficult, but also the one with the most potential for bringing about rapid and sustained improvement in governance, economic performance, and potentially, conflict resolution. I refer to the African Peer Review Mechanism, or APRM. I do not want to stray into the deliberations about content and mechanism that engaged heads of state and government in Abuja at the beginning of November 2002. I do not know for sure what was discussed and some of the political issues are outside my domain. But I do want to suggest how the IMF and other IFIs might support the economic policy and governance aspects of such a process. They seem to me to be close to the core of what the IMF has been trying to achieve in its 50-odd years—developing national and international codes of conduct for the maintenance of a stable world trading system, sharing experience between countries, offering support and advice, and occasionally delivering rebukes and invoking penalties. Therefore, it may be that NEPAD will want to adopt some of the consultation and review mechanisms of the IMF, as well as its analytical approaches.

NEPAD may also wish to make use of the reports produced by the IMF, to help it develop a set of clear and transparent guidelines on how national policy should be conducted and to assess the performance and policies of member countries. Relevant reports would include Article IV consultations, IMF-supported programs, and PRSP assessments, as well as multilateral surveillance under the WEO. These already provide background material for the macroeconomic surveillance exercises undertaken by WAEMU and CAEMC, and for the IMF and other international groupings.

To conclude, the IMF and NEPAD share the objectives of achieving and maintaining macroeconomic stability, poverty reduction, and growth in Africa. I look forward to joining with you in developing further the means to put these into practice, along the lines discussed today.

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11

Developments and Actions in NEPAD's Implementation

Isaac Aluko-Olokun

The New Partnership for Africa's Development (NEPAD) represents Africa's response to UN Secretary-General Kofi Annan's call at the Millennium Summit for a higher priority to achieve "the twin goals of freedom from want and freedom from fear." It addresses both the issues of security and stability and the issues of socioeconomic development. It is premised on the idea "no peace without development, no development without peace."

NEPAD is a holistic, integrated, and sustainable development initiative for Africa's economic and social revival. It represents a pledge that African leaders have a pressing duty to their people to eradicate poverty and to place their countries, both individually and collectively, on a path of sustainable growth and development and, at the same time, to participate actively in the world economy and body politic. The initiative is anchored on the determination of Africans to extricate themselves and the continent from the malaise of underdevelopment and their exclusion in a world that is becoming ever more globalized. It is a call for a new relationship of constructive partnership between Africans and between Africa and the rest of the international community to overcome the development chasm. The partnership is to be founded upon realization of common interest, obligations, commitments, benefit, and equality.

The initiative is premised on African states making commitments to achieving good governance, democracy, and human rights, while endeavoring to prevent and resolve situations of conflict and instability

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on the continent. Coupled with these efforts to create conditions conducive for investment, growth, and development are initiatives to raise the necessary resources to address the development chasm in critical sectors. These are highlighted in the program of action, such as infrastructure, education, health, agriculture, and information technology. Resources will be mobilized by increasing domestic savings, by improving the management of public revenue and expenditure, and by increasing capital inflows through further debt relief, larger targeted flows of overseas development assistance (ODA), and foreign direct investment (FDI).

Important Developments in the NEPAD Process

The NEPAD strategic framework document was accepted by the summit of the Organization for African Unity (OAU) in Lusaka, Zambia, in July 2001. In other words, NEPAD is the socioeconomic development framework of the OAU and the African Union (AU).

AU Summit, Durban. The AU Summit in Durban in July 2002 took a number of important decisions:

- Endorsement of the NEPAD Initial Action Plan
- Agreement by the AU Summit to encourage African countries to ratify the Declaration on Democracy, Political, Economic, and Corporate Governance and to accede to the African Peer Review Mechanism (APRM)
- Renewal of the mandate of the NEPAD Heads of State and Government Implementation Committee (HSIC) to lead implementation of the NEPAD program and to maintain the current management structure for at least another year
- Call on all member states to ensure popularization of the AU Constitutive Act and NEPAD.

The AU summit also identified a number of high priority actions and interventions in the context of the NEPAD Initial Plan. The extended Steering Committee, as well as representatives of the Regional Economic Communities (RECs), and partner organizations held a workshop in Addis Ababa, Ethiopia, August 2–4, 2002. They produced a clear statement of actions and interventions for each NEPAD priority area for 12 months and beyond.

The point was made clearly that NEPAD is not an implementing agency. Implementation will be carried out at the level of the nation states, the RECs, and by continental institutions. Implementation will remain the responsibility of designated institutions, with NEPAD acting as a catalyst, facilitator, and negotiator. Through the NEPAD process, the heads of state will enhance the effectiveness of AU structures and

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regional economic communities by speeding up political decision-making and supporting capacity building.

The individual countries constitute the nuclei of all programs and implementation actions. Central actors at this level are the governments, acting through their relevant departments or designated agencies. They are responsible for mobilizing civil society and the private sector to participate and to see NEPAD as relevant in their efforts toward enhancing development and helping to alleviate poverty. These three parties—government, civil society, and the private sector—are expected to internalize the NEPAD spirit and programs in their development plans.

The RECs, as building blocks of the AU, from the subregional level for planning, coordination, and monitoring of the integration process. The RECs will have the primary responsibility for seeking the full participation of all subregional stakeholders in the planning, development, and implementation of their respective projects. The RECs comprise intergovernmental institutions, working with associations or other subregional organizations representing civil society and the private sector, especially for the operation or operating of infrastructure and related services. The RECs will operate through their secretariats, commissions, or technical units to coordinate and facilitate the development and implementation of programs.

Priority specific workshops. A number of priority-specific workshops have been held since the AU summit in Durban, involving stakeholders and recognized experts in the field to further develop positions on each issue. Workshops on the APRM, market access, and agriculture have been held recently. This process will continue in 2003.

NEPAD-HSIC meeting. The outcomes of the NEPAD-HSIC meeting held in Abuja, Nigeria, on November 3, 2002, were as follows:

- Clarification of NEPAD as a program of the AU
- Confirmation of NEPAD as the sole AU-approved program for socioeconomic development in Africa, with a clear directive given to the AU interim commissioner to integrate all AU socioeconomic development initiatives under the NEPAD framework
- Confirmation of the need to formalize the legal status of the NEPAD program within the AU structures without sacrificing the unique strengths of NEPAD, namely, directed leadership of the socioeconomic development agenda of the continent by heads of state who meet on a regular basis and who have dedicated technical support structures with a high degree of operational autonomy
- Commitment to speeding up the implementation of the APRM
- Commitment to the comprehensive nature of the APRM

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- A call on the Steering Committee to further develop the criteria and benchmarks, particularly for political governance, and to identify the relevant institutions, including the Economic Commission on Africa and the African Development Bank, to do the technical assessment work
- Emphasis on the need to build capacity within the AU to monitor and ensure adherence to mandatory commitments arising out of the legal instruments of the AU
- Commitment to accelerating implementation of the NEPAD initiatives
- Welcomed the support of the international community and the acceptance of NEPAD as the framework for engagement with Africa, as expressed in a UN Declaration on September 16 and a UN Resolution on November 4.

Crucial and Urgent Actions and Interventions Required

There is an urgent need to address conflict prevention, resolution, and management issues, including the capacity to undertake peace support operations in accordance with the charter, as well as to build early warning capacity. To this end, the following actions should be taken:

- Strengthen institutions of political, economic, and corporate governance.
- Make operational and implement the APRM, including finalization of the composition of the independent panel of eminent persons.
- Plan and implement regionally coordinated programs to address food security and rural and agricultural development.
- Address market access issues, including the strengthening of Africa's negotiating capacity in the World Trade Organization (WTO).
- Accelerate the process of regional economic integration by selecting and implementing regional infrastructure projects in energy, information technology, water, and sanitation, by strengthening and rationalizing the RECs, and by addressing issues of intra-African trade, as well as the diversification of production and export.
- Attract private sector investment, both from within Africa and abroad.
- Pursue the issue of enhanced debt relief.
- Play a monitoring advocacy role in respect of the attainment of the UN Millennium Development Goals, especially with regard to health (HIV/AIDS, malaria, and tuberculosis) and education.

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- Enable African countries, as well as subregional and regional institutions, to access support under the Group of Eight's Africa Action Plan and other support initiatives.
- Implement NEPAD's outreach and communications strategy to ensure broad understanding, participation, and ownership in the initiative. It is essential that African private sector and civil society structures are mobilized in support of NEPAD, are provided with opportunities to engage in a meaningful manner, and are given a sense of ownership of the initiative. Much still needs to be done in this regard to popularize NEPAD on the continent.
- Ensure that gender issues and issues of capacity building are carried forward within the context of all NEPAD projects and programs.

International Support for NEPAD

NEPAD has not come into existence in a vacuum. In providing the focal point and the overall strategic framework for engagement, NEPAD does not seek to replace or compete with existing initiatives and programs, but rather to consciously establish linkage and synergies with and among them. In this way, all activities focused on Africa can be pursued in an integrated and coordinated fashion within the framework of priorities and needs identified by Africans for themselves.

Engagements have been ongoing since the OAU Lusaka Summit in 2001 to achieve the linkages and synchronicity described above. In the post-Lusaka period, an extensive program to lobby support for the initiative was undertaken. This began with the UN Economic and Social Council ministerial meeting on July 16, 2001, in Geneva, the summit of the Group of Eight countries in Genoa, Italy, on July 20, 2001, and the meeting between African leaders and leaders of the European Union and European Community in Brussels in October 2001. This theme also served as a crosscutting agenda item during the World Conference Against Racism in September 2001 in Durban. Significant interactions have been undertaken with the Group of Eight, the European Union, various agencies of the United Nations, the Bretton Woods institutions, non-Group of Eight development partners such as the Nordic states, the process of the Tokyo International Conference on African Development, and the Sino-Africa process. This culminated recently with the UN system and the international community expressing full support and accepting NEPAD as the framework for support to Africa. In this regard, a UN declaration was adopted on September 16 and a resolution on November 4, 2002.

An effort has also been made to continuously factor NEPAD imperatives into the outcomes of international conferences—such as the

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Conference on Financing for Development (FfD), the World Summit for Sustainable Development (WSSD), and the WTO—to ensure the integration of NEPAD into the multilateral system. In a wider context, countries of the South subscribe to the priorities outlined in NEPAD and have generally welcomed it with words of solidarity and moral support, as well as an appreciation for South Africa's positive role in NEPAD. Therefore, South–South cooperation is presently being pursued with more urgency.

Another major development was that of the summit of the Group of Eight countries on June 28, 2002, in Kananaskis, Canada. At the summit, the Group of Eight presented its Africa Action Plan in support of NEPAD. The African leaders reacted positively to the plan as it provides a clear commitment to the new partnership and provides a comprehensive framework for long-term engagement in support of Africa by each of the countries of the Group of Eight. Although the plan does not provide the scale of resources required, it is comprehensive in addressing the NEPAD priorities and provides for a continued system of structured engagement and the further development of detail of engagement in the project areas proposed. It was encouraging also to see a specific commitment relating to the allocation of the "new money" announced in Monterrey specifically to Africa, as well as a commitment to review the debt issue on a case by case basis regarding states not covered under the enhanced HIPC initiative.

Businesses have also enthusiastically grasped the offer of partnership. There have been a number of engagements by NEPAD with business on the continent and internationally. Meetings, starting in April 2002, have been held in Dakar, Abuja, Johannesburg, Berlin, and Durban (at the AU summit), as well as during the World Summit on Sustainable Development. In the context of international interaction, NEPAD was discussed at the World Economic Forum in New York in January 2002 and was the theme for the Africa Economic Summit in Durban in June. At the end of the Durban summit, over 130 major corporations signed a declaration supporting NEPAD and its implementation. A number of states were also identified to provide test cases of national partnership between government and business.

A NEPAD Business Group has been formed. It consists of continental and international businesses, providing them with a substantial point of entry and engagement with NEPAD. This is led by the African Business Roundtable. It includes such organizations as the International Chamber of Commerce, the U.S. Corporate Council on Africa, and the Commonwealth Business Council, among others. Business partnerships are already beginning to deliver tangible results—for example, the

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continental fiber optic cable project launched in Dakar and at the World Economic Forum meeting in Durban, and the Africa Energy Fund that is currently being established to provide a continental power grid.

Conclusion

Many fine initiatives for the development of Africa have been developed in the past, such as the Lagos Plan of Action. These failed for three major reasons that we must remember and learn from—timing (under a Cold War paradigm), lack of capacity for implementation, and a lack of genuine political will.

We are now at a critical juncture in history. Both on the continent and abroad, a leadership core has developed that is genuinely committed to the regeneration of the continent. Africa's advances in recent years and the convergence of agreement on international development goals and a common agenda for Africa illustrate this. Also, NEPAD provides three key new elements: first, it is African developed, managed and owned; second, it brings the concept of a new partnership (with mutual commitment, obligations, interests, contributions and benefits); and third, Africa is undertaking certain commitments and obligations in her own interests, which are not externally imposed conditionalities.

In conclusion, the conditions are set for the NEPAD objectives to be achieved. This unique opportunity must be firmly grasped, the present goodwill and momentum must be maintained, and implementation of NEPAD must proceed without delay. For the sake of future generations of Africans, we cannot afford to fail.

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12

Summing Up: Taking Stock and Future Steps

EVANGELOS A. CALAMITSIS

This has been a fine seminar on the New Partnership for Africa's Development (NEPAD). Since it was adopted in 2001, NEPAD has attracted worldwide interest and enthusiasm because of its new vision for Africa and its focus on a new partnership between Africa and the international community. NEPAD has been the subject of several high-level meetings and conferences and, based on the work of its steering committee and designated regional institutions, key aspects of the initiative have been further developed in recent declarations by African heads of state and government. This seminar in Dakar, organized by the IMF Institute in the context of its activities with the Joint Africa Institute, has provided an excellent occasion to deepen our understanding of NEPAD, exchange views on its opportunities and challenges, and discuss how the international community can best contribute to success.

In reviewing the background to this initiative, other seminar participants have noted that Africa's overall economic performance has continued to lag behind that of other developing regions of the world despite the progress made by an increasing number of countries. Over the past two decades, sub-Saharan Africa's economic growth in particular has been disappointing, and hence its income gap relative to the advanced economies has widened. There has been an erosion of the region's share of world trade, even for its traditional commodity exports; and there has been a steady decline in its share of global foreign direct investment (FDI). Reflecting inadequate growth, extreme poverty has spread—with almost half of the region's population now living on less

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than a $1 a day. Moreover, although education and health services have improved in some countries, most of the region's social indicators are still among the poorest in the world. Much more worrisome, HIV/AIDS has assumed alarming proportions in many African countries, shattering lives and seriously constraining growth and development. While most African countries have suffered from factors beyond their control, indications are that macroeconomic policy weaknesses, structural policy failures, and poor governance, as well as political instability and conflicts, have been mainly responsible for Africa's plight.

Against this setting, African leaders resolved to undertake NEPAD, a new vision and strategic framework for Africa's renewal. In contrast to previous plans and initiatives, NEPAD centers on African ownership and leadership of the development agenda. African states are assuming primary responsibility for addressing the existing development problems and challenges. At the same time, NEPAD calls for a new partnership between Africa and the international community, a partnership based on mutual obligations and accountability.

NEPAD has three long-term objectives—to eradicate poverty; to place African countries, both individually and collectively, on a path of sustainable growth and development; and to ensure Africa's full integration and active participation in the world economy. Accordingly, it aims at achieving the United Nations Millennium Development Goals (MDGs) for 2015—notably reducing the proportion of people living in extreme poverty (or on less than $1 a day) by half between 1990 and 2015. In line with these goals, a major objective is to realize and sustain an average real GDP growth of some 7 percent a year for the next 15 years, roughly twice the rate recorded in the second half of the 1990s. While supporting these objectives, other participants have noted that if recent external shocks were not quickly overcome and if elasticities of income of the poor with respect to overall income were lower than envisaged, growth may need to be even higher than targeted to achieve the desired goal of poverty reduction by 2015. This would pose even greater challenges for African leaders and policymakers. Some reports have suggested that on present trends only a few African countries are likely to meet most of the MDGs. Therefore, all African countries and regional institutions urgently need to redouble their efforts, not only to accelerate growth but to promote the millennium goals of poverty reduction, better health and education, gender equality, and environmental sustainability.

To attain these goals, which underscore the multi-faceted nature of poverty, NEPAD's strategic framework is based on three key elements—first, establishing the political and economic conditions for sustainable development; second, identifying priority sectors to boost growth and

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fight poverty; and third, mobilizing resources to carry out the requisite programs and projects. In this context, we had a broad exchange of views on NEPAD's major initiatives.

As regards the conditions for sustainable development, NEPAD places major emphasis on the critical role of peace, security, democracy, human rights, and sound political governance in providing an enabling framework for growth and poverty reduction. While welcoming the progress made in these areas, many participants stressed that political instability and conflicts threaten a number of African countries. Thus, it is imperative for African states, within the framework of the African Union, to enhance their capacity to prevent, manage, and resolve conflicts; ensure peace enforcement; and promote reconciliation and reconstruction. But even more important is the need to establish an enduring foundation for democracy and the rule of law—including free and fair elections; wide public participation in decision-making processes; parliamentary oversight of government activities and accountability; independence and effective judiciary; administrative structures and the civil service; and effective measures to combat corruption.

As an integral part of its overall strategy, NEPAD also underscores the key role of good economic and corporate governance in enhancing growth, reducing poverty, and promoting Africa's full integration into the global economy. In this regard, there was an intensive discussion of various aspects of NEPAD's policy framework, as well as of a number of other policies and reforms that are considered essential to achieve Africa's goals. Although it was recognized that policy options and priorities would necessarily differ across countries, there was a broad consensus on the following elements.

Consolidating sound macroeconomic conditions and strengthening competitiveness. This requires appropriate fiscal, monetary, and exchange rate policies. In this respect, participants considered that fiscal policy would have a particularly important role to play not only in ensuring financial stability and low inflation but also in promoting higher growth and reducing poverty. Therefore, in many cases, it will be essential to enhance tax efficiency and revenue collection through more effective tax policies and administration. It will also be essential to promote appropriate public expenditure management systems that would allocate adequate resources for pro-poor spending, while safeguarding overall fiscal discipline. These objectives would best be attained in the context of medium-term expenditure frameworks or similar mechanisms that can help improve budgetary processes and outcomes.

Promoting trade and regional economic integration. Although significant progress has been made in trade liberalization over the past decade, par-

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ticipants emphasized that African countries could derive greater economic benefits by opening up their economies more rapidly to the rest of the world, particularly by further simplifying and reducing their import tariff structures. But African countries also need greater access to industrial country markets. At the same time, it is important to continue to promote African integration by accelerating ongoing reform and convergence efforts in the context of the existing regional economic communities (RECs), including the Central African Economic and Monetary Community, the West African Economic and Monetary Union, and the Southern African Development Community. By ensuring larger and more efficient economic areas with wider and deeper markets, the RECs would help boost investment, trade, and growth.

Fostering private investment. To overcome existing constraints on private investment, particularly the high risks of doing business in Africa, participants stressed the importance of creating and fostering enabling environments for private initiative. This means one that provides political stability and security; engenders confidence in the sustainability of sound macroeconomic policies and market-friendly reforms; ensures that the infrastructure such as roads, telecommunications, power facilities; and necessary labor are available; and promotes a legal system that safeguards property rights, adequately enforces contracts, and protects healthy competition. Such an environment would help encourage local investors, as well as attract FDI that can bring added benefits through transfers of technology and increased access to international markets. But as mentioned by several speakers, an increase in Africa's share of global FDI will require not only an absolute improvement in the local investment environment but also a relative improvement relative to competing countries. Thus, while noting the policies and measures already implemented by several countries, participants were of the view that a relatively faster pace of reforms is needed. Moreover, further specific measures would be helpful, including increasing the number of sectors open to FDI, encouraging foreign participation in the privatization of public enterprises, and promoting efficient public/private sector partnerships for the development of priority sectors.

Building capacity and enhancing institutional reforms. These were seen as fundamental prerequisites for the achievement of Africa's goals, as they affected virtually all programs of action. Therefore, participants agreed that strong efforts are needed to support capacity building in the priority areas envisaged under NEPAD and, in this regard, to make appropriate use of technical assistance from both within and outside the continent. It will also be important to strengthen the credibility of existing institutions, notably those entrusted with ensuring democratic

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political processes and those responsible for macroeconomic policies and resource management (such as central banks, bank supervision bodies, tax and customs administrations, and audit agencies).

Accelerating sectoral reforms to promote human resource development, bridge the infrastructure gap as well as the digital divide, boost agricultural production and rural development, and protect the environment. In this respect, participants emphasized the need to boost the implementation of basic education programs to achieve universal primary education and to eliminate gender disparities in both primary and secondary education, consistent with the MDGs. They also urged vigorous campaigns to address the HIV/AIDS pandemic through comprehensive programs of prevention, care, and treatment. Furthermore, they stressed the importance of key infrastructure development not only for growth but also for regional and continental integration.

On this basis, there was a wide-ranging discussion of implementation issues and challenges. Participants noted that, to a very large extent the implementation of NEPAD's strategic framework will depend on the resolve and the steps to be taken by individual countries. Every African country will have to design its own development blueprint, consistent with NEPAD's goals. In light of individual country circumstances, this will involve setting more specific quantitative objectives, improving governance, pursuing the requisite macroeconomic policies and structural reforms, strengthening institutional capacity for effective program implementation and integration into the world economy, and transforming partnerships with donors through mutual commitments and accountability. At the same time, the regional economic communities and designated institutions, notably the African Development Bank, are expected to play a leading role in implementing regional programs and projects and, more generally, promoting African integration initiatives.

Work on national development blueprints has already progressed substantially. In recent years, many African countries have prepared interim or full-fledged Poverty Reduction Strategy Papers (PRSPs), which are focused on enhancing growth and reducing poverty. As the PRSP approach is country-driven, participatory in nature, comprehensive, result-oriented, and based on a long-term perspective for poverty reduction, it shares many of NEPAD's fundamental principles. Thus, participants considered that PRSPs or other nationally owned development strategies should serve as the main instrument for incorporating continent-wide priorities into national poverty reduction programs.

Participants considered that NEPAD provided unique opportunities for African countries to succeed by taking full control of the development agenda, working more closely together, and cooperating more

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effectively with the international community. Strict adherence to NEPAD's core political and economic principles, codes, and standards, coupled with the implementation of sound policies and reforms, would help attain the desired goals. In this respect, a particularly important ingredient of NEPAD is the African Peer Review Mechanism (APRM), which is intended to ensure that the policies and practices of participating countries conform with the agreed values and standards. As mentioned by several speakers, 12 countries have already acceded to this mechanism, and many more are expected to join. To be effective and credible, the APRM should be free of political interference, it should be conducted on the basis of objective criteria using high standards, and countries should be prepared to carry out the measures recommended by the peer reviews.

Participants also highlighted a number of challenges that NEPAD and individual country programs will have to address, notably the need to ensure wide public support as well as effective implementation and accountability. In this regard, they emphasized the following needs:

- Broaden and deepen the dialogue with all stakeholders to garner the necessary consensus and support of the desired goals and actions.
- Make sure that action plans are based on alternative policy choices and a thorough analysis of the social impact of these choices.
- Provide a comprehensive macroeconomic framework that fully integrates budgetary decisions and available and prospective means of financing.
- Strengthen the monitoring of program implementation by establishing clear indicators of progress and detailed timetables.
- Incorporate contingency plans to deal with possible external shocks and shortfalls in financing.
- Clarify the responsibilities of individual countries, regional economic communities, and designated institutions, with a view to ensuring a coherent and sustained implementation of programs and projects.

The discussions underscored the basic message that African countries and institutions will have primary responsibility for tackling poverty and realizing NEPAD's common vision for Africa's renewal. As one African leader recently noted, "There cannot be any doubt that we Africans are the central element of the problem and we cannot but be the central element of the solution." However, Africa's development efforts alone cannot ensure the desired acceleration of growth and the achievement of the MDGs. As indicated in NEPAD, to attain these goals Africa will need to fill an annual resource gap equivalent to some 12 percent of GDP. Although this will require increasing domestic savings, the bulk of the

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needed resources will have to be obtained from abroad. For this reason, African leaders have called for a much stronger, faster, and more comprehensive international support of Africa's own efforts, including new partnerships with foreign private enterprises.

The international community has welcomed NEPAD and made commitments to support strong African reform programs. Under the Africa Action Plan of the Group of Eight, the leading industrial countries have pledged substantial assistance to promote peace and security in Africa, strengthen institutions and governance, and improve health and education. Moreover, they have made commitments to give greater market access for African products, help implement debt relief packages under the enhanced Heavily Indebted Poor Countries Initiative (HIPC) initiative, and provide increased and more effective official development assistance.

The IMF and the World Bank have also expressed their wholehearted support of the NEPAD initiative. Apart from its financial assistance to African countries, notably under the concessional Poverty Reduction and Growth Facility, IMF has responded to the requirements of NEPAD by intensifying its support of capacity building efforts, particularly by establishing the first of five African Regional Technical Assistance Centers and by enhancing the training activities of the IMF Institute. It is also helping African countries through its work on internationally accepted standards and codes of good practice and the related Reports on the Observance of Standards and Codes, which could in due course serve as important inputs for the APRM. The World Bank is also strengthening its assistance programs in Africa with a view to reducing poverty and promoting sustainable development. And jointly, the World Bank and the IMF as well as the African Development Bank are actively implementing the enhanced HIPC initiative, providing substantial debt relief to African countries and thereby releasing more resources for economic and social development purposes.

While welcoming these initiatives, participants called for further broadening and strengthening of international support for Africa's development. In particular, most speakers emphasized the need for actions along the following lines:

- Increasing substantially official development assistance (ODA) to reforming African countries. According to the *Global Poverty Report* for 2002, prepared by a team led by the African Development Bank, ODA to these countries will need to be raised from the current annual level of about $13 billion to $33–38 billion. In addition, such assistance should be made more predictable; and its effectiveness should be improved by harmonizing lending instruments, streamlining procedures, and better coordination of capacity building efforts.

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- Opening up more widely industrial country markets to Africa's exports, especially by phasing out trade-distorting agricultural and other subsidies, as well as escalating tariffs and non-tariff barriers.
- Accelerating the implementation of the enhanced HIPC initiative and ensuring that the debt relief provided is consistent with a sustainable debt position.
- Actively supporting the production and supply of public goods needed to address the problems of communicable diseases, low levels of agricultural productivity, and environmental degradation.

In conclusion, participants stressed the critical importance of substantial international support to help African countries achieve, or come as close as possible to achieving, the MDGs. But we all recognize that such support will not be forthcoming, or will be much less than needed, if African countries do not deliver on the major commitments embodied in NEPAD's strategic framework. Clearly, there is urgent need not only for strong mutual commitments, but even more so, for strong actions and accountability to achieve a better future for all of Africa's people.

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