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**Title :
The Development Finance Architecture of Sub-Saharan Africa:
A Policy Paper**

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August 2009



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**The Development Finance Architecture
of Sub-Saharan Africa: A Policy Paper**

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August 2009**

Introduction

Countries of Sub-Saharan Africa (SSA) experienced a wave of accession to political independence mostly between the mid-1950s and the mid-1960s with the exception of Lusophone countries whose liberation from Portugal occurred in the 1970s. The last 50 years of SSA history have been marked by dramatic events in the political and human spheres while decades of economic strategies have sought to uplift the region. The main doctrines attempted for SSA' economic development included the episode of State-controlled economies with the underlying theories of accelerated industrialization and import-substitution strategies of the 1960s and 1970s, Structural Adjustment Programs (SAPs) spurred by market liberalization and Government disengagement from the economy during the 1980s and 1990s, and finally, Poverty Reduction Strategies brought about in the 2000s. In parallel, the last 25 years have witnessed SSA's crippling efforts to deal with its external debt crises with the help of the international community through various debt relief packages, the most notable being the Baker Plan (1985), the Brady Plan (1989) and the Highly-Indebted Poor Countries Initiative (1997).

In spite of all these efforts, SSA's current situation varies across countries but remains mostly unfavorable. The region has the highest number of countries in the bottom quarter of the rankings of the Human Development Index of the United Nations Development Program (UNDP). It is also plagued with pandemics such as HIV/AIDS and Malaria, crop ravaging natural disasters, famine, civil wars and chronic constitutional crises that often lead to civil unrest. Although there was an upturn in the past decade for some of its countries, due mostly to increases in the prices of export commodities and short term gains from sound macroeconomic management, SSA has proved to be vulnerable to global economic crises with little capacity to tackle them. Finally, the region faces increasing marginalization from global trade and investment as well as a digital divide that may preclude large fractions of its population from the information society.

The challenge then is not to seek to achieve a level of economic growth that would bring it closer to the leading economies of the world with its attendant improvement in the living conditions of its residents. Rather, it is to ensure that, given the absence of appropriate policies to turn things around, some of its parts will not slip further into economic and social regression. This rather sobering concern dictates that the goals of policymaking for SSA be aimed at making it behave more like any other developing region with the expectation that similar economic growth will ensue. The purpose of the paper is to investigate the adequacy of current development strategies, especially in the area of finance, that are applied to SSA and possibly propose measures to help make them more relevant for SSA and perhaps more effective.

1. Sub-Saharan Africa's unfavorable initial conditions

Two basic observations motivate the analysis and recommendations of the present paper. The first one is that SSA has been economically and socially underdeveloped over the last hundred years, and most of its sub-regions are likely to remain underdeveloped in the foreseeable future if drastic measures are not taken to change its course. The second observation is that, from a situation of relative parity about fifty years ago, SSA has been increasingly losing ground to other developing regions and experiencing economic divergence, a process that seems unstoppable with the policy packages that are applied today. Therefore, if SSA is not able to achieve its absolute development goals as illustrated for instance by the United

Nations’ Millennium Development Goals (MDGs) despite decades of efforts on its part with the assistance of the international community, it would perhaps be more realistic and equally instructive to aim for the objective of converging it towards other developing regions of the world. This implies that something different must be done almost exclusively for SSA.

1.1. Three characteristics unfavorable to SSA

The comparison between SSA and other developing regions assumes a certain degree of homogeneity within regions, which is not the case, but serves to underscore the vast disparities that may exist and justify remedial action more on behalf of SSA than other regions. To be justified this intended differentiated treatment must be based on characteristics that set SSA apart and unquestionably hamper its development prospects, even in comparison to other developing areas. Three characteristics seem to emerge. The first one is related to the magnitude and degree of satisfaction of social demand; the second one highlights impediment to trade through the high incidence of land-locked countries and the third regularity captures the uncertainty surrounding future economic prospects as measured by the variability of export earnings over time.

As Table 1 shows, SSA has a low Per Capita Gross National Income (GNI), and the lowest Life Expectancy at Birth, which is only 51 years. In other words, the South Asian has an average production lifetime that is longer than that of the Sub-Saharan African by 14 years while for other developing regions the difference ranges between 19 and 22 years. SSA’s considerably larger Rate of Population Growth underscores the growing social dimensions of its underdevelopment which its workforce may not be able to remedy considering its low life expectancy. This challenge is compounded by the region’s low Net Rate of Primary School Enrolment, which assigns the lowest per capita productivity to the Sub-Saharan African. In summary, compared to other developing regions, SSA is likely to have larger social needs that it may have difficulty satisfying because the proportion of unproductive young people is higher and grows faster, and its work force dies younger and has lower productivity than anywhere else in the world.

Table 1. Key Statistics and Indicators of Selected Developing Regions, 2007

Region	Per Capita Gross National Income in U.S. \$, Atlas method	Life Expectancy at Birth in Years	Rate of population Growth in %	Net Rate of Primary School Enrolment in %	Number of land-locked Countries
Sub-Saharan Africa	951	51	2.4	69.5	15
Latin America and Caribbean	5801	73	1.2	93.9	2
South Asia	880	64	1.5	85.2	3
East Asia and Pacific	2182	72	0.8	93	2
Middle East &	2820	70	1.7	90.1	0

North Africa					
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Source: World Bank Key Development Data and Statistics, World Bank.

The last column of Table 1 indicates the number of land-locked countries in each developing region. Of the 15 land-locked SSA countries, 12 are among the 26 countries that have the lowest Human Development rankings according to the Human Development Index (HDI) 2006 of the United Nations Development Program (UNDP). Land-locked countries in other developing regions also tend to rank low on the HDI in their respective regions. This strong correlation between lack of access to the coastline and lack of human development afflicts SSA more than any other region. As has been often pointed out, being land-locked can be considered to hinder development.¹

Recent instances of strong and sustained economic growth in the developing world have been export-led. This is the case for China and India nowadays, and Singapore, Taiwan, Korea and Malaysia two decades ago. Therefore, the economic growth of developing countries can be significantly affected by the rate of growth and variability of their export earnings. More specifically, fast expansion of exports fuels economic growth while highly variable exports may affect it negatively. In order to carry out comparisons between regions, the annual rate of growth of nominal exports of goods and services F.O.B. expressed in U.S. Dollars and deflated with the U.S. Producer Price Index is calculated for each sampled country for the period 1970-2008. Then the average, standard deviation and coefficient of variation are computed for each country over the same period. Finally, the means of these statistics are calculated across countries in each developing region and reported in Table 2. The list of sampled countries appears in Appendix 1.

Table 2. Statistics of Real FOB Export Growth by Selected Developing Regions, 1970-2007

Region	Mean Average Rate of Export Growth , in %	Mean Standard Deviation of Rate of Export Growth”, in %	Mean Coefficient of Variation
Sub-Sahara Africa	8.3	33.4	5.1
Latin America & Caribbean	6.4	19.4	3.4
South Asia	7.7	15.3	2.1
East Asia & Pacific	9.4	26.0	3.9
Middle East & North Africa	9.4	24.9	3.1

¹ See Faye, Michael, McArthur, John, Sachs, Jeffrey, and Snow, Thomas, 2004, “The Challenges Facing Landlocked Developing Countries”, *Journal of Human Development*, Vol. 5(1), 31-68; and Limao, N. and Venables, A., 1999, “*Infrastructure, Geographical Disadvantage and Transport Costs*”, World Bank Working Paper No. 2257, World Bank, Washington D.C; and MacKeller, L., Worgotter, A. and Worz, 2000, “*Economic Development Problems of Landlocked Countries,*” *Transition Economics Series* 14, January, Vienna: Institute for Advanced Studies .

Source: IMF, International Financial Statistics Online; Computations by the author.

Column 1 in Table 2 shows that, over the 38 year sample period, SSA has recorded an average export growth performance of 8.3% that ranks it in the middle of developing areas. It has done better than South Asia and Latin America & the Caribbean, but not as well as East Asia & Pacific or the Middle East & North Africa (MENA). However, the variability of its export growth is markedly higher than that of other regions. At 5.1 its coefficient of variation of export growth is 31.8% higher than that of the region with the next highest coefficient of variation (East Asia & Pacific) and almost two and a half times that of South Asia. In conclusion the third characteristic that adversely affects SSA's economic growth prospects is that its export earnings are highly volatile, even when compared to those of other developing regions. It is noteworthy that export diversification may not be readily available to most SSA countries given their lack of competitiveness outside their traditional export sectors.

1.2. Impact of adverse initial conditions on SSA growth prospects

The extent to which the disparities identified above harm SSA's economic development prospects requires further scrutiny. With respect to its capacity to generate enough wealth to meet its social needs, SSA is at a major disadvantage because the average lifetime per capita production, which is the product of the number of productive years and the average annual productivity, is lower than in other regions because both arguments are lower for SSA than for other developing regions. Furthermore, the level of social demand is higher and will be increasingly higher for SSA than for other developing areas. Indeed SSA's rate of population growth is higher while its larger proportion of poor arising from a lower primary school enrolment will reduce, through social spending, more than in other regions, the level of resources otherwise invested in other aspects of economic development.

A vast empirical literature has uncovered the negative impact of a country's distance from the coastline on its economic growth performance. This relationship points to the cost of transportation as a key determinant of a country's ability to open up and integrate into the world economy. In the absence of a competitive advantage that fuels international trade, a country is isolated and lags in acquisition of trade-induced technological advance, whether through invention or transfer, which further compounds the adverse effect of its land-locked status. Considering that technology embodies technical knowledge, a land-locked country tends to fall behind in its process of human capital formation. Moreover, most land-locked SSA countries have neighbours that are hardly more developed, which limits the potential trade-induced developmental gains that arise through land-based cross border transactions.

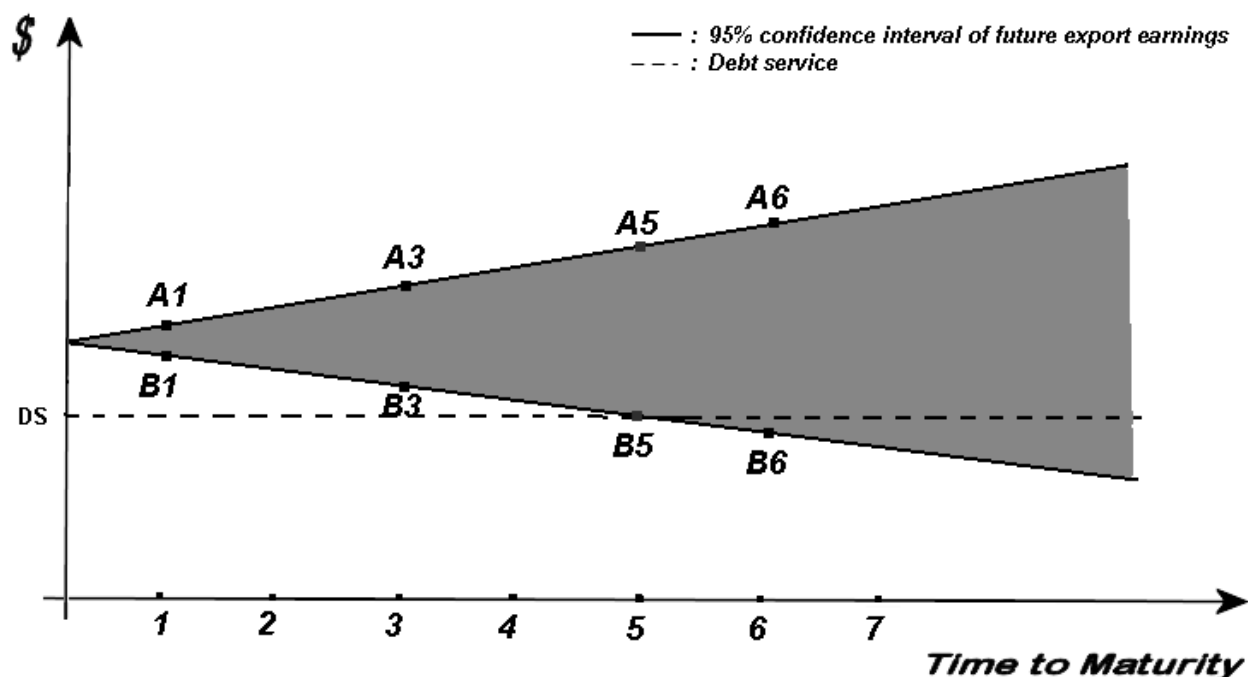
Figure 1 illustrates the adverse impact of high variability of a country's export proceeds on its future economic prospects. Consider an African country that borrows externally and commits to make annual payments equal to DS until the maturity of the loan. The equal payments DS are represented by the horizontal dotted line. The horizontal axis depicts years to maturity while the vertical line indicates Dollar amounts. Export earnings of African countries follow a random walk, which means that the variance of their underlying probabilistic distribution increases proportionally as the time horizon over which it is calculated increases (Seck, 2006). Therefore, the confidence interval within which export earnings are expected to fall with a given confidence level will also increase over time and has a conical graphic shape. For instance, in Figure 1, at a 95% confidence level, the country's export earnings one year

from now will fall between A1 and B1. If the forecast is extended to three years the corresponding 95% boundaries are A3 and B3 respectively.²

If external debt is serviced solely with a country's export proceeds, a country is almost sure to repay its annual debt instalment equal to DS, although a residual risk of non-payment remains, as long as the dotted line is below the grey area. However, as the maturity of the loan increases, the dotted debt service line eventually intersects with the lower boundary of the confidence interval of the export earnings distribution and there is stronger likelihood that the country will face debt service difficulties after that date. This eventuality is higher the higher the variability of a country's export earnings, which is the case of African countries compared to countries in other developing regions.

² This analysis borrows from Seck, D. "On the Design of A New Mechanism for Africa's External Debt" in Boko. S., and Seck, D. NEPAD and the Future of Economic Policy in Africa, Africa World Press, Inc, Trenton, N.J., 2008, pp. 317-353.

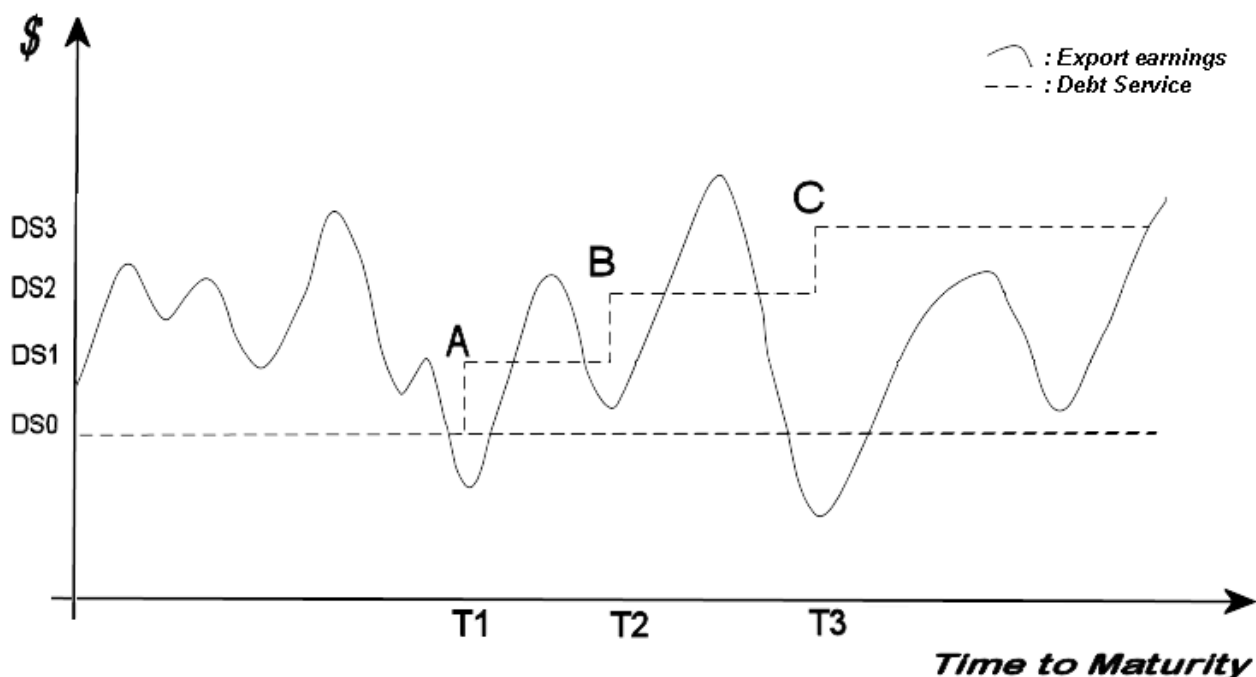
Figure 1 : Static forecast of future debt service difficulties



In Figure 1, the analysis is static because it is entirely conducted at the time of the loan contract, $t = 0$. Figure 2 depicts a dynamic forecast of the country's future external debt difficulties because it includes events that emerge after the loan contract has been signed. The actual value of exports earnings is represented by the continuous line and replaces the confidence interval represented by the grey area in Figure 1. The initially contracted debt service amount that was denoted by DS in Figure 1 is denoted by DS_0 in Figure 2. Consider a borrower country whose export proceeds have been higher than its contractual debt service until the year T_1 . At T_1 , its export earnings fall below DS_0 and it cannot service its external debt.

As a result, the accrued interest on its debt service payment is capitalized and its new annual debt service payment is increased to DS_1 as indicated by the stepped up dotted line starting at point A. Therefore, the country's debt service is higher than its initial value and the probability that its future export earnings will cover it decreases. With future debt service difficulties the country experiences new capitalizations of accrued interest on its unpaid debt service obligations. Consequently, increasing higher debt service amounts, denoted by points B and C, burden the country's development efforts and debt crises become more frequent. This process of ballooning of external debt obligations is more likely to happen the longer the initial maturity of the debt contract. In summary, the long held view that developing countries must borrow long term to finance their long term development must be challenged because with extended maturities there is an increasingly higher probability of debt service difficulties, given the characteristics of the probabilistic distribution underlying their export earnings.

Figure 2: Dynamic forecast of future debt service difficulties



The foregoing analysis has given evidence that SSA suffers from initial conditions that put it at a disadvantage compared to other developing regions. Some of these conditions stem from its demographic and geographic characteristics while the high variability of its export earnings makes it difficult to undertake long term development planning or make effective use of external sovereign borrowing without facing a high probability of future debt service crises. Consequently, it is argued that any attempt to improve the development prospects of SSA, even to the level of other developing regions, must seek to level the playing field by implementing remedial measures that will be organized around a new development finance architecture, supported by consistently sound macro-economic policies that help prevent major domestic imbalances.

2. A new development finance architecture for SSA

In light of the adverse characteristics that beset SSA's growth potential and make it diverge economically even from other developing regions, what appropriate policy reforms are needed to remedy the current situation? Based on the evidence, the policy package needs to include identification of sectoral priorities to address the demographic and geographic challenges of the sub-region as well as financial arrangements, not just financial flows, that ensure long term sustainability of economic development.

2.1. SSA's sectoral priorities

Table 1 illustrates the demographic challenge faced by SSA with respect to its lowest life expectancy, highest population growth and lowest primary school enrolment among developing regions. This combination of factors is incompatible with autonomous sustainable development because the region cannot finance its spiralling social needs. In order to break the resulting vicious circle of current needs exceeding available resources, priority must be

given to significantly larger expenditures in the human development sector particularly in health and education. Such a policy will have the intended effects of raising the life expectancy and consequently the per capita lifetime production, and enhancing the average productivity of SSA. As household incomes increase, it is expected that the rate of population growth will decrease, a demographic process that has been observed in other developing regions. This will, in turn, reduce the extent of SSA's social needs and release additional resources that can be devoted to other requirements for development.

The second sectoral priority arises from the high incidence of land-locked countries in SSA compared to other developing regions, as also indicated in Table 1. While geographic location is exogenous, it is arguably one argument in a country's transport cost function. Other arguments in the same function can play a countervailing role and help reduce the negative impact of distance from the coastline. Trade facilitating infrastructure can be considered a prime candidate to offset landlocked status. Even within the borders of large countries, rail and road transport have historically brought secluded regions closer to markets and ensured their economic development. Air transport is also playing an increasingly important role in this respect. Landlocked SSA countries have very poor infrastructure in general and trade-related infrastructure in particular. Therefore, they must make efforts to increase their level of trade facilitating infrastructure to lessen the adverse impact of their geographic location and further integrate into the world economy.

In conclusion, investment in social development and trade-related infrastructure can be considered imperative requirements that will help SSA catch up with other developing regions. To be successful a financial architecture aimed at supporting the region's development efforts needs to take these two sectoral priorities into account. The main characteristics of the development finance architecture proposed for SSA are discussed below.

2.2. Architecture for SSA's development finance

The current development finance situation

The current architecture of SSA's development finance has the following main components. Domestic financial sources include Government's fiscal revenue and domestic borrowing, private sector finance which comprises bank lending and equity including household self-financing. International sources of funding refer to grants, sovereign and private sector borrowing, private inflows composed of foreign direct investment, portfolio investment and foreign remittances. In order to be practical, the discussion on the new architecture will focus on sources of funding over which the international development community has some control. This precludes all domestic sources and private international inflows. In other words, attention will be focused on foreign grants and sovereign and private sector international borrowing from public lenders. These channels are more amenable to public policy reform at the regional level. The other sources of funding are within the scope of private sector or sovereign national decision-making.

Have foreign grants and international loans prevented SSA from falling increasingly behind other developing regions and, if not, what remedial measures can be taken? With respect to grant making, the consensus on its historical performance and shortcomings is captured by the Paris Declaration and the ongoing debate on aid. The following list enumerates the main critiques levelled at Official Development Assistance (ODA):

- Recipient countries do not have a strong sense of ownership of aid packages
- There is poor alignment of donor practices with recipient countries' procurement and accounting policies
- Donors display limited willingness to harmonize their practices and to work in unison
- ODA needs to move away from process-based mechanisms in favour of a results-based framework
- Recipient countries suffer from asymmetric accountability in favour of donors
- The technical assistance component of ODA is costly, inadequate, often imposed through tied aid and does not empower local staff
- Donors impose excessive conditionality
- Politically-motivated allocation of aid distorts priorities and does not reflect recipients' actual needs
- The unpredictability of the level and composition of aid flows makes recipient countries' long term planning difficult.
- Aid flows to SSA have been deemed historically insufficient.

In view of all these critiques and the results it has yielded, one may wonder why the current ODA system has managed to remain in place for so long and is consistently utilized in one form or another by so many in the donor community. The Paris Declaration recognizes many of the pitfalls listed above but has not been very successful at removing them all. Consequently, the search for new aid mechanisms is still warranted, especially in light of the increasing role of new donors like China that espouses an approach to aid that is different from the current practice of traditional DAC donors. Table 3 reports the major uses of aid in 2007 and illustrates the lack of adequacy of Development Assistance Committee (DAC) aid relative to the development needs of developing countries in the areas of social development and infrastructure. The World Bank and the Regional Development Banks seem to do better in economic infrastructure but not in social development.

Table 3. Aid to All Recipients by Major Purposes in 2007, in %

	TOTAL DAC	European Commission	World Bank	Regional Dev. Banks ^d
Social and administrative infrastructure	40,5	39,2	31,8	25,2
Education ^a	9,1	5,7	7,7	3,4
<i>of which:</i> Basic education	2,5	0,8	1,6	2,0
Health	4,7	3,0	1,6	1,2
<i>of which:</i> Basic health	3,3	2,1	0,6	0,3
Population ^b	6,1	0,7	2,0	-
Water supply and sanitation	4,7	3,7	10,5	7,7
Government and civil society	12,5	17,8	5,3	12,0
Other social infrastructure/service	3,5	8,4	4,8	0,8
Economic infrastructure	12,7	15,1	31,8	46,7
Transport and communications	4,4	7,7	17,0	30,2
Energy	4,1	4,7	11,2	11,4
Other	4,1	2,7	3,7	5,1
Production	6,1	9,6	9,1	14,2
Agriculture	4,6	3,4	8,1	5,6
Industry, mining and construction	0,9	3,8	0,7	8,1
Trade and tourism	0,6	2,3	0,3	0,5
Multisector	7,1	10,2	1,4	12,3
Programme assistance	4,5	9,2	25,8	0,8
Action relating to debt ^c	10,5	0,2	-	-
Humanitarian aid	7,5	10,7	0,0	-
Administrative expenses	5,3	5,1	-	-
Other and unspecified	5,8	0,9	-	0,8
TOTAL	100,0	100,0	100,0	100,0
<i>Memo item:</i>				
Food aid, total	2,9	4,5	-	-

a) Including students and trainees.

b) Population and reproductive health.

c) Including forgiveness of non-ODA debt.

Source: OECD DAC Statistics Online, Table 19.

Table 4 summarizes for each developing region the evolution of external debt of various sources and maturities over a fifteen year period. In light of the foregoing analysis, four observations are noteworthy. First, SSA carries too much external debt compared to other developing regions, not in absolute amount, but in view of the high variability of its export earnings. Indeed, the higher its total indebtedness, the higher its expected debt service obligations and the higher the probability of occurrence of future debt service difficulties. In other words, SSA should borrow significantly less than other developing regions, which was not the case in 1990 or in 2005. Second, SSA has too much long term debt considering that its highly volatile export earnings may be insufficient to service debt obligations that are very distant in the future.

The third observation relates to the inadequacy of the level of private non-guaranteed external debt compared to the other regions and to the need to develop the private sector in SSA. The long held view that the private sector is the engine of economic growth in the developing world seems to have been backed up by external debt finance in every developing region except in SSA where, arguably, it was most needed given previous decades of government-controlled economic activity. Indeed, between 1990 and 2005, SSA's private sector borrowing from external sources increased by only \$7.7 Billion U.S. Finally, while separate statistics are not available in Table 4 for IDA credit, one must underscore the possible inadequacy of this facility because, although extended on concessionary terms, its loans carry fixed debt obligations over very long maturities for debtor countries deemed poor but also saddled with highly volatile export earnings. In this regard, it is legitimate to examine whether this soft loan window should be replaced by a pure grant facility. The same can be said of the African Development Fund of the African Development Bank.

Table 4. External Debt Statistics of Selected Developing Regions, in \$ Billions

	Total external debt		Long term debt		Public and publicly guaranteed debt		Private nonguaranteed external debt		IBRD loans & IDA credit		Use of IMF credit	
	1990	2005	1990	2005	1990	2005	1990	2005	1990	2005	1990	2005
Sub-Saharan Africa	176.6	214.8	149.4	176.7	144.1	163.8	5.3	13.0	24.9	50.5	6.6	5.9
Latin America & Caribbean	444.6	727.6	352.7	621.9	327.7	419.6	25.0	202.3	35.9	40.4	18.3	13.1
South Asia	124.4	191.5	107.5	177.4	105.8	141.7	1.7	35.8	30.7	50.3	4.5	2.2
East Asia & Pacific	234.1	621.2	194.6	400.2	173.0	256.3	21.6	143.9	25.3	39.9	2.1	8.5
Middle East & North Africa	139.5	152.7	118.0	124.3	116.6	113.3	1.4	11.0	10.1	10.1	1.8	0.5
Total	1119.2	1907.8	922.2	1500.5	867.2	1094.7	55.0	406.0	126.9	521.2	33.3	30.2

Source: World Bank, World Bank Indicators 2007, Online, Table 4.16

Proposals for a new development finance architecture for SSA

The foregoing analysis has uncovered three characteristics that are thought to be related to SSA's lack of economic convergence with other developing regions. It is proposed that sectoral priorities that include social development and infrastructure be the focus of future policies to remedy the current situation. This section makes recommendations on financing packages aimed at achieving this goal. The discussion will first address the financing facilities that are deemed adequate for the program. The key institutional actors that could help in its success will be identified afterwards.

Financing facilities for SSA

The financing facilities that could help enhance SSA's economic prospects relate to the design and management of SSA's external borrowing and to grant making policies. Two new approaches are proposed with respect to external debt facilities. The first one seeks to substitute SSA's sovereign credit risk with liquidity risk. The rationale is that after 25 years of external debt crises with a long string of ex-post debt relief plans, SSA needs to be shielded from the uncertainty of future debt service difficulties and plan for its long term economic growth. Considering that historically debt relief packages mostly addressed the consequences of debt crises rather than their causes, the purpose of the three facilities proposed below is to prevent these crises in the future.

The first facility is to reduce the stock of sovereign external debt in order to lower future debt service obligations. In this regard, initiatives such as the Highly Indebted Poor Countries (HIPC) and other debt forgiveness and debt exchange mechanisms can play a significant role. The goal of the second facility is to make service on external sovereign debt contingent on the export earnings performance of the debtor country. If the contractual periodic debt service payment is manageably low as prescribed in the first facility, a country can be considered fundamentally solvent and shortfalls in its export revenues will be expected to be minor and of limited duration. In such instances, the debtor country could be authorized to postpone all or part of its contractual debt service payment, with or without recapitalization of interest, and resume its scheduled payments when its export performance improves. Through this facility the credit risk that has plagued SSA countries for many years is transformed into a mere liquidity risk. Lenders that are unwilling to carry the liquidity risk could sell it to other market participants more adept at pooling it and therefore diversifying across borrowers. By the same token, private foreign lenders could also be given protection by their governments through insurance schemes comparable to those offered to exporters.

The goal of the third facility is to replace concessionary lending instruments such as IDA with pure grant windows to maintain SSA countries' access to external sovereign financing without the pitfalls of fixed long term debt service obligations described above. Its implementation would constitute a suitable substitute for the current practice towards SSA countries. Indeed, the combination of the ex-ante grant element in concessionary loans and increasingly generalized loan forgiveness, especially under HIPC, yields a present value of debt service inflows going to lenders that is close to zero. The pure grant facility has the dual advantage of removing the burden of future debt service payments for cash-strapped SSA governments and significantly reducing the financial uncertainty surrounding future development planning. Arguably, a pure grant facility is more likely to yield satisfactory results if recipients are held to high standards of external accountability and domestic governance that satisfy the requirements of fiduciary responsibility of donors. Such standards should be an integral part of the proposed financial architecture.

The second approach that is recommended for the development finance architecture of SSA is to strengthen its process of international crowding in. Table 4 documents the low recourse of SSA's private sector to external borrowing, unlike other developing regions, which is detrimental to the unleashing of its growth potential. Countries that have recently experienced episodes of high economic growth have also promoted their private sector, notably in the cases of export-induced growth. Given its scarcity of domestic capital and low savings rate, SSA needs to fund its private sector through international borrowing.

Although most of the critiques levelled at ODA are known and discussed in the Paris Declaration and elsewhere, the record for SSA does not provide evidence of improvement likely to enhance the region's prospects for economic development. Therefore, a new initiative could complement the current architecture in the pursuit of SSA's grant-aided development efforts. The proposal seeks to establish two grant making pools to provide exclusive support for SSA: the Development Pool (DP) and the Common Pool (CP). The Development Pool will help finance individual countries' development programs in priority sectors such as social development and infrastructure while the Common Pool will fund all other eligible programs and projects that are submitted by countries, the African Union (AU) and Regional Economic Communities (RECs) of the region. All SSA countries with a per capita Gross National Income (GNI) not exceeding U.S. \$1000 will be eligible for the Development Pool while the Common Pool will be open to all African countries, the African Union and RECs.

Private Sector will be encouraged to participate in the Development Pool with grants and in the Common Pool possibly with profit-seeking joint venture investments. Civil Society's contribution will be in the form of charitable donations and purchase of non-refundable, non-income bearing development shares. The donor community will provide funding through ODA, the International Finance Facility, other development facilities, international levies such as the Airline Tax, and Exceptional Drawing Rights to be issued by the IMF. The domestic funding counterpart of African countries will include tax revenues and a number of new levies. The levies include a penny of additional excise tax for each pack of cigarettes sold (Penny-A-Pack or PAP tax), a dime for each bottle of alcoholic beverage sold (Dime-A-Bottle or DAB tax) and one U.S. Dollar for each international personal money transfer originating in an OECD country and destined to SSA (Dollar-A-Transfer or DAT tax). DAC members will be urged to channel the equivalent of 0.1% of their GNI to the Development Pool at its inception and 0.5% of their GNI after 5 years. Their contributions to the Common Pool will be voluntary and the amounts discretionary.

To be eligible for Development Pool assistance countries will be requested to submit a Poverty Reduction Strategy Paper (PRSP), a Strategy for Accelerated Growth or comparable documents. Standard economic documents such as Sector-Wide Investment Programs or NEPAD implementation strategy briefs will be adequate for requests submitted to the Common Pool. For each proposal the World Bank, the IMF and the African Development Bank (AfDB) will, in their capacity as knowledge institutions, be requested to provide written non-binding observations as technical assistance to the selection process. In order to lessen the incidence of tied aid, donor-specific conditionality, political targeting of recipients and the practice of Trust Funds will be kept to a minimum. To mitigate the incidence of information asymmetry and reduce the incentive for moral hazard, accountability and governance standards coupled with verifiable monitoring benchmarks will be put in place to govern eligibility criteria and compliance rules. The two pools will be administered by an Aid

Council for Africa (ACA) that reports to the Secretary General of the United Nations. The composition of the ACA will comprise representatives of SSA countries, of participating donors as well as institutions and individuals appointed by the Secretary General of the United Nations. The African Union, the World Bank, IMF and the AfDB will serve as observers. Table 5 summarizes the main features of the two pools.

Table 5. Proposed Design for Aid Council for Africa

Panel A. FINANCING	Development Pool (DP)	Common Pool (CP)
Initial contribution	TBD	TBD
Annual contribution amount	TBD	TBD
Funding sources Foreign contributions	Bilateral: - ODA expenditure - International Finance Facility Multilateral: - Reserve Draw-down - Special Drawing Rights (IMF) International levies: - Airline Ticket (AT) Tax	Bilateral: - ODA expenditure - International Finance Facility
Africa's contributions	Governments: Tax revenues International levies: Penny-A-Pack (PAP) Cigarette tax Dime-A-Bottle (DAB) Alcohol tax - Dollar-A-Transfer (DAT) tax on international personal bank transfers	Governments: Tax revenues
Private sector contributions	Donations Import price reductions	Private investment flows
Civil Society contributions	Charitable donations Volunteer work	Purchase of development shares
Terms of funding for recipients	Pure grants for all sources	Pure grants for foreign, African and Civil Society contributions Market profitability for Private Sector investments
Timetable of Funding delegation	DAC countries to transfer to Pool 0.1% of GNI at start and 0.5% of GNI by year 5.	No mandatory transfer required

Duration of pool	Pool expires in 2025	Pool expires in 2025
Panel B. ELIGIBILITY		
Type of support	Budget support	Economic growth projects
Recipients	Sub-Saharan African countries	All African countries African Union (AU) Regional Economic Communities (RECs)
Eligibility threshold	Per Capita GNI less than \$1000	None
Submission document	PRSP or Accelerated Growth Strategy	Country Sector-Wide Investment projects NEPAD implementation documents RECs Implementation documents
Institutional external vetting	Non-objection by WB, IMF, ADB	Non-objection by WB, IMF, ADB
Main conditionality	Observance of governance requirements and expenditure standards	Observance of governance requirements and expenditure standards Evidence of economic impact
PANEL C: GOVERNANCE, MONITORING and REPORTING		
Governance body	Aid Council for Africa	Aid Council for Africa
Composition of Council	- Donors African countries Appointed by SG of United Nations	- Donors African countries Appointed by SG of United Nations
Observers	WB, IMF, AfDB, AU, OECD	WB, IMF, AfDB, AU, OECD
Administration of funds	WB and AfDB	WB and AfDB

Source: D. Seck, adapted from “A New Architecture for the Financing of Africa’s Development”, Unpublished monograph, United Nations African Institute for Economic Development and Planning (IDEP), May 2006.

Roles of institutional actors

The changes and innovations proposed would have direct implications for the roles and operations of the financial institutions that serve Africa. The role and mode of operation of the Aid Council for Africa are described above. Current financial and development institutions could be reviewed and mandated as follows.

The World Bank and the African Development Bank

- Reduce the total stock of outstanding external sovereign debt of SSA, refrain from further sovereign lending and terminate concessionary loans, usually extended through IDA and the African Development Fund.
- Transform these windows into pure grant facilities
- Increase significantly loans to SSA's private sector
- Provide technical assistance to recipient countries and the Aid Council for Africa.

Bilateral and other multilateral donors

- Reduce the stock of outstanding external sovereign debt of SSA and refrain from further lending to SSA sovereign borrowers
- Replace loans with sovereign grants
- Support private sector funding schemes

The International Monetary Fund

- Increase resources available for balance of payments relief interventions on behalf of SSA countries
- Provide exceptional Special Drawing Rights to SSA countries to support their development efforts
- Provide technical support to recipient countries and the Aid Council for Africa.

It is noteworthy that the African Union is in the process of establishing a number of continent-wide financial institutions. Their roles and collaboration with existing institutions could be the focus of future discussion when they become fully operational.

Conclusion

SSA has been afflicted by more than a century of economic underdevelopment and is increasingly losing ground to other developing regions. A number of characteristics that set it apart and could be contributing factors in its unfavorable situation include demographic challenges such as lower life expectancy, higher population growth and lower net primary school enrollment. These factors limit SSA's ability to address its social needs, a situation that will be exacerbated in the future if nothing is done to remedy it. Furthermore, SSA is the developing region with the highest number of land-locked countries, which constitutes a major impediment to trade and integration into the world economy. Finally, exports proceeds of SSA countries are significantly more variable than in other developing countries, a factor that undermines their capacity to fulfill external debt obligations with certainty and consequently to plan for sustainable long term development.

In order to achieve the more modest objective of securing economic convergence between SSA and other developing regions the adverse impact of the regularities identified above must be mitigated. In this respect, SSA's sectoral priorities should include significantly larger expenditures in social development and trade facilitating infrastructure. Furthermore, new facilities should be integrated into a development finance architecture designed to address the region's needs. With respect to external borrowing, the stock of SSA's sovereign debt, including on concessionary terms, should be reduced drastically and replaced with pure grants to sovereign recipients. Debt service payments on outstanding external sovereign debt should be made contingent on a debtor country's export earnings performance. Considering the strong growth potential usually ascribed to the private sector of export-led fast growing economies, SSA's private sector should have expanded access to international lending markets.

Aid-assisted development of SSA could be better achieved through establishment of a Development Pool and a Common Pool under the auspices of the United Nations with financial contribution from bilateral and multilateral donors, Private Sector and civil Society. The Development Pool will support SSA countries' investment in priority sectors such as social development and infrastructure while the Common Pool will be open to projects and programs of countries, Regional Economic Communities and the African Union. A number of levies could provide additional funding to the Aid Council for Africa in charge of administration of the two pools as well as to African countries' revenue base. The proposed innovations would entail changes in the mandate and operations of the key financial development institutions to facilitate enhanced economic growth of SSA.

Appendix 1: List of Countries Sampled for the Computation of Statistics of Real Growth of Export Earnings, 1970 – 2007; See Table 2 for results.

<u>Sub-Saharan Africa</u>	<u>Latin America & Caribbean</u>	<u>East Asia & Pacific</u>
Benin	Argentina	China, P.R. Mainland
Burkina Faso	Bahamas, The	Indonesia
Burundi	Barbados	Lao People's Dem. Rep.
Cameroon	Belize	Malaysia
Congo, Republic of	Bolivia	Myanmar
Cote d'Ivoire	Brazil	Papua New Guinea
Equatorial Guinea	Chile	Philippines
Ethiopia	Colombia	Thailand
Gabon	Costa Rica	Tonga
Gambia, The	Dominican Republic	Vanuatu
Ghana	Ecuador	
Guinea	Guatemala	<u>Middle East & North Africa</u>
Kenya	Haiti	Bahrain, Kingdom of
Lesotho	Honduras	Egypt
Madagascar	Jamaica	Iran, I.R. of
Malawi	Mexico	Jordan
Mali	Paraguay	Kuwait
Mozambique	Peru	Lebanon
Nigeria	Trinidad & Tobago	Libya
Senegal	Uruguay	Morocco
South Africa	Venezuela, Rep. Bolivarian	Oman
Swaziland		Saudi Arabia
Tanzania	<u>South Asia</u>	Sudan
Togo	Bangladesh	Syrian Arab Republic
Uganda	Bhutan	Tunisia
Zambia	India	
Zimbabwe	Maldives	
	Nepal	
	Pakistan	
	Sri Lanka	

N.B. The sample period is shorter for some countries.

Appendix 2. Net Disbursements of ODA to Sub-Saharan Africa by Recipient
(USD million at 2006 prices and exchange rates)

	1991- 1992 average	1996- 1997 average	2004	2005	2006	2007
Angola	400	517	1 217	449	171	225
Benin	356	298	410	356	375	429
Botswana	167	120	50	50	66	97
Burkina Faso	557	477	675	714	870	848
Burundi	365	103	380	375	415	425
Cameroon	800	553	819	429	1 689	1 746
Cape Verde	142	140	152	168	138	148
Central African Rep.	223	147	115	95	133	161
Chad	324	312	346	395	284	324
Comoros	72	40	27	26	30	40
Congo, Dem. Rep.	482	198	1 920	1 847	2 049	1 112
Congo, Rep.	159	435	121	1 493	259	116
Côte d'Ivoire	894	829	170	115	251	152
Djibouti	139	106	66	78	117	103
Equatorial Guinea	81	36	31	40	26	28
Eritrea	-	175	281	365	129	142
Ethiopia	1 463	846	1 914	1 973	1 948	2 227
Gabon	139	98	42	54	31	44
Gambia	136	46	58	63	74	67
Ghana	958	673	1 469	1 179	1 176	1 055
Guinea	526	412	286	206	161	207
Guinea-Bissau	142	187	80	81	82	112
Kenya	1 126	616	682	786	943	1 184
Lesotho	175	120	101	71	72	120
Liberia	180	147	227	240	268	645
Madagascar	521	734	1 313	942	750	828
Malawi	732	505	534	599	684	676
Mali	577	552	617	731	825	926
Mauritania	269	300	197	205	190	333
Mauritius	73	40	34	34	19	67
Mayotte	96	141	219	208	338	365
Mozambique	1 659	1 154	1 319	1 332	1 605	1 619
Namibia	212	217	183	117	145	190
Niger	468	355	575	534	514	498
Nigeria	338	236	610	6 603	11 432	1 867
Rwanda	459	434	516	595	586	655
Sao Tome & Principe	72	51	35	33	22	33
Senegal	823	594	1 104	707	826	771
Seychelles	27	22	11	15	14	3
Sierra Leone	152	186	396	361	344	489
Somalia	549	106	215	248	392	351
South Africa	-	540	662	701	720	733
St. Helena	23	22	28	23	28	39
Sudan	917	220	1 061	1 892	2 052	1 951
Swaziland	72	34	23	46	35	58
Tanzania	1 562	1 118	1 860	1 534	1 825	2 643
Togo	269	159	68	86	79	110

Uganda	900	929	1 288	1 229	1 549	1 592
Zambia	1 218	756	1 194	1 191	1 426	967
Zimbabwe	762	428	199	386	279	430
South of Sahara, regional	909	1 007	1 513	1 153	1 590	1 577
OVERALL TOTAL	23 668	18 472	27 412	33 154	40 025	31 521

Source: OECD DAC Statistics Online, Table 30.

Appendix 3. Total Net Flows from DAC Countries by Type of Flow

(in Million US Dollars)

	1991-1992 average	1996-1997 average	2003	2004	2005
I. Official Development Assistance	58 453	52 028	69 065	79 432	107 0
1. Bilateral grants and grant-like flows	35 678	33 925	50 888	57 246	83 4
of which: Technical co-operation	13 143	13 515	18 352	18 672	20 7
Developmental food aid	1 707	951	1 196	1 169	8
Humanitarian aid	2 003	1 783	4 360	5 193	7 1
Debt forgiveness	4 508	3 260	8 317	7 134	24 9
Administrative costs	2 314	2 788	3 545	4 032	4 1
2. Bilateral loans	7 139	1 818	-1 153	-2 942	-1 0
3. Contributions to multilateral institutions	17 513	16 286	19 330	25 127	24 6
of which: UN	4 694	4 209	4 828	5 129	5 4
EC	4 350	4 794	6 946	8 906	9 2
IDA	5 505	4 027	3 120	5 690	4 8
Regional development banks	1 503	1 564	1 734	2 274	2 0
II. Other Official Flows	8 097	5 926	- 350	-5 601	1 4
1. Bilateral	7 474	6 164	- 820	-5 349	2 2
2. Multilateral	622	- 238	470	- 252	- 8
III. Private Flows at market terms	29 996	126 216	46 573	75 262	179 5
1. Direct investment	25 495	68 008	49 340	76 901	100 6
2. Bilateral portfolio investment	6 324	59 222	-6 164	-3 544	73 3
3. Multilateral portfolio investment	-1 075	-3 537	1 083	-4 657	
4. Export credits	- 748	2 523	2 313	6 561	5 5
IV. Net grants by NGOs	5 704	5 480	10 239	11 320	14 7
TOTAL NET FLOWS	102 249	189 649	125 527	160 412	302 7

Source : OECD, DAC Online Statistics.

