



Global Development Challenges for Africa in 2006

This chapter deals with Africa's global development challenges in 2006. These challenges particularly relate to trade negotiations at the multilateral and bilateral level and to financing development. It is clear from analysis at the continental level that results are mixed when trade negotiations and the financing development issues are considered together. Thus, this chapter shows that although there is good news at the level of financing development with progress in debt relief initiatives, commitment to scale up aid in order to achieve the MDGs and agreement to improve aid effectiveness, trade negotiations are far from realizing Africa's priorities. In particular, at the level of multilateral trade negotiations, there has been limited progress towards addressing the priorities of Africa in a way that would enable trade to realize its potential as a key pillar for economic development of the continent. In the same vein, bilateral trade negotiations especially between African countries and developed country economies such as is the case with the EU are raising major challenges given the centrality of reciprocity in these negotiations.

“The average export performance of non-oil exporting SSA countries is very much in line with the world average”

3.1 Developments in trade negotiations

World trade expanded significantly between 2000 and 2005. Total world exports increased from \$US6,451 billion in 2000 to \$10,393 billion in 2005, an increase of 61 per cent.¹ Table 3.1 allows for a comparison of this evolution with African exports over the same period.

Table 3.1 shows that over the past 6 years, world merchandise exports experienced an average growth rate of 10.4 per cent. Over the same period, Africa performed better, increasing its exports by 16 per cent on average annually. However, breaking down the export performance by subregion reveals that the rapid increase in exports is particularly concentrated in oil-exporting SSA countries.² These countries achieved an average export growth of 22.4 per cent over the period. On the other hand, the average export performance of non-oil exporting SSA countries is very much in line with the world average (11.2 per cent).

This seems to be further proof that the recent gains in Africa's exports is not based on diversification of the export base but is based rather on increased oil exports.

1 WTO online world trade statistics, in dollars at current prices

2 Angola, Chad, Congo, Equatorial Guinea, Gabon, Nigeria and Sudan.

Moreover, table 3.1 shows that the variability of exports by oil producers is higher than for other countries, probably owing to the volatility of oil prices. The recent improvement in Africa's export performance therefore appears to be vulnerable to shifts in international commodity prices, particularly in changes in oil prices.

“Africa's share of global exports of merchandise remains low”

Table 3.1
Comparative merchandise export performance, World and Africa, 2000-2005 (\$US billion)

Region	Exports	2000	2001	2002	2003	2004	2005	Yearly average 2000-2005
World	Exports in current prices	6451.0	6184.0	6484.0	7752.0	9191.0	10393.0	7712.5
	Growth rate (%)		-4.1	4.8	16.8	21.4	13.1	10.4
Total Africa	Exports in current prices	147.1	137.4	140.6	176.5	230.0	295.8	187.9
	Growth rate (%)		-6.6	2.3	25.5	30.3	28.6	16.0
Republic of South Africa	Exports in current prices	30.0	29.3	29.7	36.5	46.0	51.9	37.2
	Growth rate (%)		-2.4	1.6	22.7	26.2	12.7	12.2
North Africa	Exports in current prices	52.7	48.0	48.1	60.8	79.4	106.1	65.8
	Growth rate (%)		-8.9	0.1	26.4	30.7	33.5	16.4
Sub-Saharan Africa oil-exporting countries	Exports in current prices	37.1	32.1	32.4	43.6	62.4	91.6	49.8
	Growth rate (%)		-8.9	0.1	26.4	30.7	33.5	22.4
Sub-Saharan Africa non-oil-exporting countries	Exports in current prices	27.2	27.7	30.1	35.5	41.9	45.9	34.7
	Growth rate (%)		2.2	8.4	18.1	17.9	9.6	11.2

Sources: WTO online data, November 2006; UNECA 2006b.

What is more, despite a recent slight recovery, Africa's share of global exports of merchandise remains low. Figure 3.1 shows the evolution of its share in global exports from 1965 to 2005. Its share in 2005 was 2.85 per cent only, roughly the equivalent of its 1991 value and less than half its peak value in 1980 (5.97 per cent). For comparative purposes, Africa accounted for 14 per cent of world population in 2005.³ At the current rate of growth of African exports and according to the United Nations population growth estimates, the continent would have to wait until 2045 for its share in world exports to match its share of world population.⁴ Non-oil-exporting

³ United Nations Population Division, UN-DESA, online statistics, November 2006.

⁴ Projections for all African countries (including oil-producing and North African countries), estimate a continuation of the average export growth rates over the past five years and of United Nations projections for population growth.

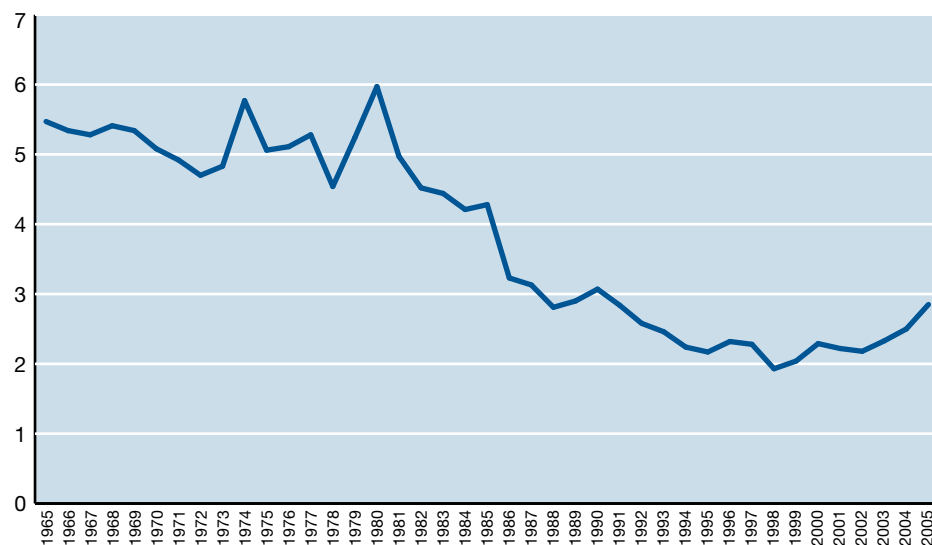
SSA countries currently account for 8.5 per cent of world population. At the current rate of growth of their exports and even without taking account of their increasing weight in total world population, these countries would have to wait until 2387 (382 years!) to see their export share match their share of world population.⁵

In light of the situation of low export performance and dependency on the prices of just a few commodities, diversification should remain a priority objective for all African countries, particularly but not only for SSA countries.

“ Investment and diversification depend on a number of internal factors such as governance, regulatory environment, productivity and comparative advantages ”

Figure 3.1

Africa's share in total world merchandise exports, 1965-2005 (per cent)



Source: WTO online data, November 2006; UNECA 2006.

Investment and diversification depend on a number of internal factors such as governance, regulatory environment, productivity and comparative advantages, etc. However, external factors also help to set the conditions for diversification. These include effective market access, regional integration and the multilateral and other international trade agreements that are currently being negotiated.

Much was expected of a successful Doha Development Round of WTO negotiations launched in 2001 at the Fourth WTO Ministerial Conference from 9 to 14 November 2001, in Qatar. Numerous studies suggested that there would be significant gains for developing countries. Likewise, it was often expected that Economic Partnership Agreements (EPAs) with the EU would result in improved business environments in African countries, allowing for more investments and enhancing the prospects for economic diversification. This section takes stock of the developments in the trade negotiations in which African countries are involved.

⁵ Evaluation for non-oil-exporting SSA countries, without taking account of their projected population growth.

WTO trade negotiations evolving since 2001

The 2001 Doha Development Round of WTO trade negotiations saw ups and downs in the deliberations up to July 2006 when progress stalled. Talks have resumed since then informally and on a low-key basis but the prospects for a breakthrough still appear dim.

“A fundamental expectation with the Doha Round, therefore, was that it would correct the remaining imbalances in trade rules in favour of developing countries”

The Doha Development Round

The Declaration of the Fourth Ministerial Conference in Doha provided the negotiation mandate for the Round. Developing countries, among them African countries, considered development dimensions to be crucial in fulfilling the Doha mandate which was to reform the multilateral trading system and improve their prospects in global trade. The pro-development agenda was expected to address the skewed nature of the division of global trade benefits, with most gains going to the developed countries. The Doha mandate was supposed to put development at the centre of the discussions with achievement of this mandate to the satisfaction of developing countries the yardstick with which success would be measured.

A fundamental expectation with the Round, therefore, was that it would correct the remaining imbalances in trade rules in favour of developing countries and improve rules to provide developing countries with genuine market opportunities. Negotiations on services and agriculture were programmed by the “in-built agenda” clauses of the Marrakesh Agreement.⁶ Importantly for African countries and the African, Caribbean and Pacific (ACP) countries, the Doha meeting also secured a waiver for the transitional arrangements of the Cotonou provisions for EU-ACP countries. The waiver permitted the legal application of the Cotonou preferential trade regime, until its expiry on 31 December 2007. The Doha mandate evolved and was fine-tuned with the subsequent Ministerial Conferences in Geneva, Cancún, and Hong Kong, in 1998, 2003 and 2005, respectively.

The Cancún Ministerial Conference of 2003

In Cancún, in September 2003, the Fifth WTO Ministerial Conference that was intended for stock taking of positions again ended in a deadlock. The main contentions crystallized around the unresolved “Singapore issues”: investment, competition, government procurement and trade facilitation. There was also deep

6 The Marrakesh Agreement establishing the World Trade Organization (WTO) was signed on 5 April 1994 and entered into force on 1 January 1995. It developed out of the general Agreement on Tariffs and Trade (GATT) and was a culmination of issues and arrangements tackled at the Uruguay Round of 1986.

disagreement over the treatment of cotton and other agricultural commodity and subsidy issues.⁷

The July Framework Agreement of the WTO General Council

It took member States until July 2004 to achieve any substantial progress on the issues that had stalled the negotiations in Cancún in 2003. After several weeks of intense deliberations, the member States agreed on a text that represented significant progress in clarifying the modalities.

The July Framework Agreement showed progress on agriculture, the Singapore issues and, to some extent, on Non-Agriculture Market Access (NAMA).⁸ The text of the July Framework Agreement dropped the Singapore issues with the exception of trade facilitation. With regard to agriculture, advances were achieved on the three pillars identified, with special and differentiated treatment (S&D) featuring in all aspects. Domestic support measures were to be reduced using a tiered formula, implying steeper reductions for the highest level of subsidies. On export competition, the Framework Agreement stipulated reduction of export subsidies, with a view to phasing them out, even though no date was proposed for their concrete elimination. The choice of a tiered formula was also retained for market access. Least Developed Countries (LDCs) were exempted from all tariff cuts. It was further decided that treatment of cotton, one of the causes of contention in Cancún, would be treated under the agriculture negotiations; a sub-committee was created to address this issue “ambitiously, expeditiously and specifically”.

The text of the July package was less clear concerning the choice of a particular formula for NAMA reductions. Negotiations had been delayed by the late progress achieved on agriculture, with many members refusing to invest too much effort in NAMA while the outcome of the negotiations in agriculture was still unknown. The July Framework also defined new deadlines for further advancing the negotiations.

However, most of the interim deadlines were missed and not much happened in 2005. The little progress achieved up to the Sixth WTO Ministerial Conference in Hong Kong in December 2005 included a system to assess the ad-valorem equivalent of non-ad-valorem tariffs. Other important issues remained unresolved.

7 The Singapore issues emerged from the first WTO Ministerial Conference in 1996 and centred on investment protection, competition, policy transparency in government procurement, and trade facilitation.

8 The 2004 July Framework agreed by WTO members came under the overall Doha Development Agenda timeline. Members were asked to clarify and improve GATT Article V on Freedom of Transit, Article VIII on Fees and Formalities of Importation and Exportation and Article X on Publication and Administration of Trade Regulations. The package also agreed on technical and capacity-building assistance to developing countries, cooperation between customs and other trade facilitation authorities and customs compliance issues.

Sixth WTO Ministerial Conference in Hong Kong

This Sixth WTO Ministerial Conference resulted in the Hong Kong Declaration in December 2005 that outlined further progress in the negotiations, although it failed to bridge significant gaps. The main developments brought about by the Declaration included an end date of 2013 for agricultural export subsidies, and end of 2006 for cotton subsidies. Precision was also added to the modalities on agriculture, notably the number of bands for the tiered formulae. Progress was also made on the definitions of sensitive products, special products and special safeguard mechanisms. The Declaration chose a Swiss formula for tariff reduction under NAMA.

With regard to agriculture and NAMA, the Hong Kong Declaration set out a deadline for establishing modalities, particularly on the depth of tariff cuts and domestic subsidies reduction by 30 April 2006, with a view to establishing detailed schedules of commitments by 31 July 2006. On services, the Declaration called for improved offers and included a timeline to do so.

Another major highlight of the Declaration of particular importance for many African countries was the decision to grant duty-free and quota-free (DFQF) market access to LDCs. This extended to 97 per cent of products but notably excluded some textile and garment products. Such market access was to be granted to LDCs by developed countries and also by developing countries in a position to do so.

The Sixth Ministerial Conference in Hong Kong also resulted in an agreement for transparency on rules for regional integration. Finally, the Hong Kong Declaration also called for the creation of a task force on Aid for Trade. Discussions on Aid for Trade had developed during the course of 2005 in parallel with the WTO process.

The pause in the negotiations: July-November 2006

The Hong Kong Declaration had set several deadlines for reaching agreement on modalities. These deadlines were all missed during the first trimester of 2006 and, by the end of June 2006, a meeting of Ministers and Heads of Delegations was called in Geneva. Despite intense discussions on agriculture and NAMA, no agreement on modalities was reached. The issue was discussed at several levels including during the G-8 meeting in July 2006. Finally, after another unfruitful attempt to break the deadlock during a G-6 meeting, Pascal Lamy, the Director-General of WTO, on 27 July 2006, called for the talks to be suspended as, in his view, there was need for reflection and “quiet diplomacy.”

The deadlock in WTO negotiations appeared to be primarily associated with disagreement over the levels of demand and offers on agriculture. In particular, it seemed that EU and USA would not agree on the levels of necessary concessions with regard to market access against reductions in domestic support.

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The suspension of the talks was clearly a setback for the multilateral process, prohibiting the international community and especially poorer countries from gaining significant improvements in the multilateral trading system. This freeze in negotiations was all the more worrying in light of the expiration of the Trade Promotion Authority (TPA) or “fast-track” at the end of 2007.⁹ This constitutes a de-facto deadline for the current Round.¹⁰

From July to November 2006, there were no official negotiations. On 16 November 2006, however, the WTO Director-General called for an informal trade committee meeting to re-launch the consultation process, as there appeared to be a consensus that WTO members were keen to revive the negotiations. The section below explores the achievements so far in the Doha Round from an African perspective.

Positions and prospects in WTO negotiations issue by issue

WTO negotiations have featured prominently in the headlines during the past couple of years. However, the main protagonists, particularly EU and USA, have not managed to bridge major differences on agriculture. This led to the deadlock in the negotiations in July 2006, with resumption of talks under discussion at the moment of writing. Despite the lingering and significant disagreement among the various parties, the negotiations have achieved some clear advances. This section details those advances that are of special interest to African countries. It is hoped that they will not be lost if the negotiations stall again.

Agriculture

Agriculture is a sector of key interest for African countries, as it could be a main contributor to poverty reduction and diversification policies (UNECA 2005). Agricultural issues have been the most contentious in the negotiations. Nevertheless, some advances were seen in the African common positions, either in the form of agreed principles or in bracketed text.

The main achievements of negotiations under agriculture included first and foremost the decision to abolish all export subsidies by 2013 and by the end of 2006 for cotton exporters. As negotiations are still blocked, the opportunity of the elimination of cotton export subsidies by end 2006 has already been missed.

In terms of market access, the negotiations established a tiered formula with four bands resulting in steeper cuts for higher tariffs. There were also talks of tariff cap-

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9 The TPA allows the American Administration to negotiate international trade agreements and present the outcome to the US Congress for an acceptance vote without the possibility of amendments.

10 Resuming negotiations after 2007 would probably mean waiting for the next US administration to extend a renewed TPA, the timing of which is unknown.

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pings. UNECA research has shown that African countries overall would reap larger benefits from a significant reduction in tariffs (UNECA 2005a). The formula applies different sets of cuts to developed and developing countries, in line with the proportionality principle sought by African countries (African Union 2005). Moreover, LDCs were also exempted from reducing tariffs. This would have allowed most African countries to preserve substantial policy space in agriculture, another major objective of the Africa group.

The principles of sensitive products, alongside special products and special safeguard mechanisms were also agreed despite wide disagreement on actual figures. Developing countries, including those from Africa, had strongly argued in favour of special products and special safeguard mechanisms that would be reserved for developing countries and allow special treatment for goods that have a role in rural development and the livelihoods of rural communities.

Advances were also achieved on domestic subsidies. The choice of a tiered formula had been retained for cutting domestic subsidies, both for the blue box and the Aggregate Measures of Support (AMS). This should translate into higher reduction of the subsidies in countries where they are higher. Further disciplines were proposed on de-minimis subsidies. A substantial reduction of domestic support measures including subsidies in the North were supposed to match the long-term interests of most African countries (UNECA 2005; Osakwe 2006).

Non-Agriculture Market Access (NAMA)

Although they had been somewhat delayed due to lack of progress on agriculture, talks on NAMA had also made some significant advances. For example, LDCs would be exempted from tariff cuts, an important objective for many African countries. The talks also allowed the choice of a Swiss formula for tariff reductions, entailing larger cuts on higher tariffs and a harmonizing effect (UNECA 2004).

The principle of proportionality in tariff cuts for NAMA products was also emphasized in the Hong Kong Declaration. Developing countries were permitted to proceed to smaller tariff cuts than developed countries. However, the precise level of coefficients for the formula remained undecided. The level of these coefficients is crucial as it determines the depth of the tariff cuts and whether or not the cut goes beyond simply reducing “water in the tariff” and results in actual reductions in applied rates. S&D is therefore available through the NAMA differentiated formula.

S&D treatment for developing countries was also reflected in NAMA negotiations through another provision of the Hong Kong Declaration: paragraph 8, which enabled developing countries to either shield a proportion of their tariffs from the effect of the formula, or alternatively to opt for a less-than formula reduction of tariffs for a larger number of their tariffs. Under NAMA, only those developing countries with more than 35 per cent of bound tariff lines had to apply the formula, which means

that eight African developing countries have to apply the formula.¹¹ Other countries had to increase their binding.

UNECA studies show that while an overly ambitious liberalization scenario in NAMA could lead to gains in welfare for Africa, there is also a risk of de-industrialization of the continent in favour of specialization in agricultural production (UNECA 2006b). Apart from a few important products that are still protected by high tariffs in developed countries, the potential gains in terms of depth of tariff reductions appear to be greater in other developing markets (South-South trade).

Special and differential treatment (S&D)

The pro-development agenda of the Doha Round had different dimensions. These included S&D treatment, enhanced market access, balanced rules, policy space and flexibilities. The ability of the Round to ensure that the multilateral system strengthened the development dimensions for the benefit of developing countries is of major interest to African countries in the negotiations. African countries in particular advocated for S&D treatment to be mainstreamed in all aspects of the negotiations in order to enable them to achieve their legitimate development goals.

Such treatment relates to the preferential provisions in the final agreement in favour of developing countries and LDCs, the two categories in which African countries feature. For instance, through S&D treatment in agriculture negotiations, African countries were looking for modalities that would allow them to pursue agricultural policies in support of development, poverty reduction strategies, food security and rural livelihood concerns.

S&D treatment underpins the quest in the Doha Round for full operationalization of the principle of proportionality in the modalities. By taking into account the existing tariff structure of the African countries the treatment would help to strengthen the development dimensions of the Doha Round. With respect to the industrial tariffs, the modalities aimed at reducing or eliminating tariff peaks, high tariffs, and tariff escalation and would allow autonomy to African countries to pursue industrial policy in line with their development strategies. It would also allow them to initiate and deepen diversification of their economies.

Other issues

In services, negotiations had been initiated prior to the Doha Round by the so-called “in-built agenda” as stipulated by paragraph 1 of Article XIX of the General Agreement on Trade and Services (GATS). Negotiations on services resumed in January 2000, before the Doha Ministerial Conference. Noteworthy for African and other

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¹¹ These eight countries are Botswana, Egypt, Gabon, Morocco, Namibia, South Africa, Swaziland and Tunisia (UNECA 2006b).

“ “ There is no “one size fits all” in international trade in services ” ”

developing countries, Article XIX-2 of GATS made S&D treatment an explicit element of the GATS negotiations. Therefore, developing countries were only expected to undertake commitments in trade-in-services liberalization compatible with their development levels.¹²

Negotiations have been following a “request and offer” approach. Deadlines for submissions have been missed but since March 2003, 69 offers have been made and 30 of them subsequently revisited.¹³ These offers cover both sectoral and horizontal/multisectoral proposals. As with the negotiations on agriculture and NAMA, and of importance to many African countries, LDCs are not expected to undertake new commitments in services in the current Round. For other African countries, negotiations in services represent both opportunities and challenges (UNECA 2005a, UNCTAD 2005).

Trade in services has increased significantly worldwide and African countries do have some potential comparative advantages in service sectors such as tourism and in labour-intensive sectors covered by Mode 4. Moreover, the international provision of business support and infrastructure services in sectors such as insurance, banking, and consulting can greatly reduce the cost of doing business and increase competitiveness in developing countries (UNCTAD 2002). On the other hand, liberalization must be planned and sequenced carefully and requires development of an appropriate regulatory framework (UNCTAD 2005a).

There is no “one size fits all” in international trade in services and the negotiations in services liberalization cover a very large number and variety of industries. For developing countries, and in particular African ones, the progress in the negotiations – as highlighted by the small number of offers - is hindered by the lack of experience in negotiating their interests in services. African countries need development support both for their supply capacity in services and for their capacity to participate effectively in negotiations on trade in services. It is suggested by several observers (for example Sauvé, 2006) that Aid for Trade programmes should be targeted at enhancing the capacities of African countries to respond to such challenges.

Talks on trade facilitation progressing significantly

A consensus has also been reached on application of certain trade facilitation provisions by developing countries in exchange for systematic provision of technical assistance to meet them. WTO has always dealt with issues related to trade facilitation and WTO rules include a variety of provisions that aim to enhance transparency and set minimum procedural standards. Among them are GATT Articles

12 GATS Art XIX-2: “*The process of liberalisation shall take place with due respect for national policy objectives and the level of development of individual Members, both overall and in individual sectors. There shall be appropriate flexibility for individual developing country Members for opening fewer sectors, liberalising fewer types of transactions, progressively extending market access in line with their development situation [...]*”.

13 Seven African countries have made proposals: Egypt, Gabon, Kenya, Mauritius, Morocco, South Africa and Tunisia.

V, VIII and X, which deal with freedom of transit for goods, fees and formalities connected with importation and exportation, and publication and administration of trade regulations. As part of the Doha Work Programme, the General Council decided by explicit consensus to commence trade facilitation negotiations on the basis of clearly defined modalities.

The Trade Facilitation Negotiating Group made considerable progress before WTO negotiations were suspended in July 2006. Several proposals had been tabled. However, addressing the issues of technical assistance and capacity building (TA/CB) as well as S&D proved to be a major challenge. It was unanimously acknowledged that TA/CB for trade facilitation should respond to the specific needs of WTO member States. However, the specific TA/CB issues to be addressed within the WTO framework were unclear. In this regard, it was generally agreed that self-assessments on trade facilitation needs at national level were critically important for African countries because they could facilitate engagement with the donor community among other benefits. A number of tools, including those developed by WTO and the World Customs Organization (WCO) were proposed for conducting such national assessments. The National Trade Facilitation Committees in some African countries would provide appropriate forums to work on these assessments.

It also emerged during the negotiations that access to available resources for capacity building from the donor community remained a challenge to African countries because existing procedures were complex. To address this problem, they continuously stressed the need for a simplified template for requesting technical assistance and capacity building from donors. In terms of the scope of negotiations, they have reiterated the broad scope of trade facilitation, and argue that, in addition to activities aimed at improving customs efficiency, considerable efforts should be made in other areas such as transit transport management. This was especially important for the continent's 15 land-locked countries.

Regarding the possible structure for a Trade Facilitation Agreement (TFA), the notion of a "trade facilitation ladder" has been emerging that would define the levels of facilitation to which countries would commit themselves. The philosophy behind this notion has been that all WTO members should be required to sign up to the lowest level of standards, with those countries that are most able, implementing a far higher level of facilitation. It was envisaged that the negotiators would define the number of steps in the ladder and their content. Finally, there was convergence on the view that there should be an additional facilitative procedure to resolve disputes arising from trade facilitation commitments, as taking recourse to the Dispute Settlement Procedures should be the last resort

On rules for regional integration, a decision of the Negotiating Group on Rules established a transparency mechanism for regional trade agreements (RTAs). This decision applies to all RTAs provisionally and will be replaced by a permanent mechanism upon the completion of the Doha Round. The discussions on establishing

“*Considerable efforts should be made in other areas such as transit transport management*”

criteria for assessing WTO compatibility with RTAs have not, however, progressed significantly.

One of the most noteworthy achievements for Africa at the Round so far has been the proposition to grant LDCs DFQF, market access to developed countries and to developing countries in a position to do so.¹⁴ This proposition had been championed by EU. Unfortunately, other developed countries, particularly the USA, insisted on watering it down to apply DFQF to only 97 per cent of all products, which allowed for the exclusion of key products such as some textiles and apparel. This decision could still benefit African LDCs as one of the criticisms of preferential schemes such as the Everything but Arms (EBA) initiative is that they lack the legal security conferred by a WTO commitment.

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Aid for Trade talks represent significant advance

The recent inclusion of Aid for Trade talks on the agenda of the Round is another significant advance. Aid for Trade is not part of the mainstream undertaking, so progress on this issue could be independent from the rest of the Round. The introduction of Aid for Trade under WTO auspices could allow for more transparency and coherence on this issue. It is also hoped that this will increase availability of resources for Aid for Trade programmes, for which there seems to be great scope. Such programmes could facilitate trade negotiations through the reinforcing of African negotiating capacities. They also contribute to developing capacity for applying meaningful S&D treatments in a range of negotiation areas.

Improvements in Africa's negotiating capacities

African negotiating capacities, which have proved inadequate in past negotiations, have evolved over time. One of the most significant developments has been the increased participation of African countries in the actual negotiations. In the past negotiations, including the 1986 Uruguay Round, African countries played a peripheral role. In the current Doha Round, African countries are not only engaged actively in the definition of the mandate for the negotiators, but have been active at every stage as the negotiations have progressed. This active participation and engagement have highlighted the priorities and concerns of Africa and its desire to ensure that multilateralism benefits all, especially through operationalization of S&D treatment in every aspect.

The visible engagement of African countries in the negotiations has been driven mainly by more effective organization of their participation. The African Union Commission (AUC) has led the political efforts and the coordination of the negotiations. This coordination has been able to maintain a strong solidarity among African

¹⁴ Brazil recently announced its intention of granting duty-free, quota-free (DF QF) market access to LDCs.

countries despite their diversity. The African Group in Geneva is able to participate in the negotiations from a common framework on all the key issues of interest. Thus, the current common negotiating framework that they are using to inform their positions has been developed under AU coordination and was endorsed by the AU Summit in Banjul, Gambia in July 2006. The AU Summit Decision was based on the outcome of the Conference of African Trade Ministers held in Nairobi in April 2006.¹⁵

The coordinated technical support provided to African negotiators has been another important development. Many institutions have provided inputs to the political process spearheaded by AU. ECA has been playing a major role through its African Trade Policy Centre (ATPC) with the support of the Canada Fund for Africa. Other institutions playing key roles in providing technical support to the political process include WTO, UNDP, UNCTAD, International Trade Centre (ITC) and research networks such as African Economic Research Consortium (AERC), Council for the Development of Social Science Research in Africa (CODESRIA) and International Lawyers and Economists Against Poverty (ILEAP). Civil society organizations (CSOs) have also been active in advocating for African priorities in the trade negotiations. These include non-governmental organizations (NGOs) operating regionally and internationally. The Third World Network (TWN), South Centre, and OXFAM, among others, have played a major role in advocating issues of concern to African countries.

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The EPA negotiations

The long-standing Lomé preference system between APC countries and EU was reformed in 2000 with the signature of the Cotonou Treaty. Cotonou rolled over the existing unilateral trade preferences up to the end of 2007 when they should be replaced by a WTO-compatible trade arrangement. The Cotonou trade arrangements are currently not compatible with the WTO rules on preferential trade arrangements (Lang 2006). Indeed, they fit neither the criteria of Article XXIV which call for reciprocity and liberalization of substantially all the trade, nor that of the Enabling Clause which entails that preferences are extended to all developing countries or all LDCs. ACP countries and EU had to seek a waiver from other WTO members for the Cotonou Agreement, and this was granted in Doha in November 2001. The waiver expires at the end of 2007. It is expected that the negotiations on the regime to succeed the Cotonou arrangements will have been concluded by this date.

15 The Nairobi Ministerial Declaration on Doha Work Programme was issued by the 4th Ordinary Session of the AU Conference of Ministers of Trade, held 12-14 April 2006, in Kenya. It was an update of previous Declarations including: the Cairo Declaration and Road Map on the Doha Work Programme, from the 3rd Ordinary Session of the AU Conference of Ministers of Trade, 5-9 June 2005, in Egypt, the Kigali Consensus and Declaration on the Doha Work Programme at the 2nd Ordinary Session of the AU Conference of Ministers of Trade, 27-28 May 2005, in Rwanda, and the July Framework Agreement of the WTO General Council of 1 August 2004.

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ACP countries and EU have opted to negotiate Economic Partnership Agreements (EPAs), which will be FTAs between ACP Regional Economic Communities (RECs) and EU. In Africa, EPAs are being negotiated with the Economic and Monetary Community of Central Africa (CEMAC), the Economic Community of West African States (ECOWAS), Common Market of Eastern and Southern Africa (COMESA) and the Southern African Development Community (SADC).

The negotiations on EPAs were launched in 2002. They revolve around market access, fisheries, sanitary and phytosanitary (SPS) measures, agriculture, services, investment and competition. Negotiations have evolved differently across the regions. Each region has so far established a roadmap with the EU outlining the way forward for the negotiations. Generally, there has been growing concern in Africa that EPAs, while representing significant potential for growth and development, also carry challenging adjustment costs. Evidence shows that EPAs could also translate into tariff revenue losses, de-industrialization and reductions in intra-African trade (UNECA 2004; 2005). African countries have called for enhanced support to capacity building and financing. EU argues that such tools already exist and that the discussions concerning their improvement are independent of EPA negotiations. The focus of the negotiations for Africa has therefore shifted to the development dimension of EPAs.

The negotiation process is further complicated by the overlapping memberships of African countries in various RECs (UNECA 2006b). African countries and EU appear to be in agreement that EPAs should be an opportunity to enhance regional integration in Africa. Impact studies on EPAs (UNECA 2004) show that the sequencing of liberalization is key to the development of the continent. This would probably translate into a back-loaded tariff reduction on imports from EU, while liberalization within RECs would be a priority. EU has also shown signs of readiness to allocate additional resources to improvement of interregional trade infrastructure, which would benefit African regional integration.

Article 37.4 of the Cotonou Agreement in 2001 stated that the Parties would conduct a formal and comprehensive review of the process, structure and substance of the negotiations, in 2006.¹⁶ This review is under way at the time of writing. Preliminary results seem to indicate that, in several regions, the process of negotiations is evolving more slowly than expected, partly due to disagreements with EU on the development dimension of the EPAs but also because of the difficulties some countries and regions face in forming internal consensus and informed positions on technical and sectoral issues. The formal review will identify the necessary means to allow timely completion of the negotiations by 1 January 2008. Should the negotiations fail to reach conclusion by end of 2007, the question of a WTO waiver will have to be reconsidered.

¹⁶ The Cotonou Agreement guides EU's development cooperation with ACP countries. The treaty was signed in Benin in June 2000 and entered into force in 2002. It aimed at eradicating poverty and fostering sustainable development and at integrating ACP countries into the world economy.

One of the questions that recently gained importance in talks regarding EPAs is the potential alternative to the FTAs currently envisaged. The Cotonou Agreement called for all alternatives to be explored. So far, the main alternatives appear to be enhanced preferential schemes such as the Generalized System of Preferences (GSP) and the Everything but Arms (EBA) initiative (Bilal and Rampa 2006). Further analytical work on this issue is crucial.

The standstill in WTO negotiations also complicates the EPA process. In the absence of evolution on rules for preferential trade arrangements, major uncertainties remain on the degree of flexibility African countries have on the length of transition periods and on the coverage of liberalization (Lang 2006). In this context, there is a risk that negotiators will feel constrained and opt for conservative EPA provisions, retaining few sensitive products and short transition periods.¹⁷ This could translate into more acute adjustment costs for African countries in terms of both de-industrialization and regional integration. UNECA research shows that the impact of EPA on African economies could be positive only under a scenario of substantial asymmetry in the degree of liberalization. In particular, the African Party would have to be able to retain a significant share (up to 40 per cent) of trade out of the coverage of liberalization, while EU would have to be willing to open its markets entirely to African exports (Perez and Karingi, forthcoming).

The breakdown in WTO negotiations also affects other issues in the EPA negotiations. For example, African countries are concerned that gains in access to the EU market for agricultural products may not translate into increased exports as long as international prices remain distorted by subsidies to farmers in the North. Likewise, there may be a potential risk that opening service markets to EU producers may only result in situations of unhealthy monopolies or oligopolies in the service markets of African countries. As a consequence, African countries may feel bound to extend liberalization of their service markets to other WTO members, without obtaining the benefits of reciprocal concessions from these third parties.

EPA negotiations are the major task ahead of African trade policymakers, especially since the freeze of the Doha Round. These pose great challenges but also real opportunities in terms of development for the continent. In view of the short time remaining for completion of the negotiations, it is important that all the parties involved step up their political commitment to successful EPAs. The ongoing comprehensive review process should be seized as an important opportunity to propose solutions to resolve pending issues within Africa and between African groupings and the EU.

Generally, there are some positive developments in the negotiations so far, even if these may still be too limited to make Doha a true development agenda. With the suspension of the talks, there is a risk that these advances may be lost or delayed for

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The standstill
in WTO
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17 The traditional interpretation of Article XXIV is that EPAs should cover at least 90 per cent of trade between the Parties, and should cover all sectors. Moreover, the Understanding on Article XXIV stipulates that transition periods should exceed ten years only in exceptional circumstances.

a long time. In this respect, some have started to call, albeit reluctantly, for an agreement *a-minima*, which would probably mean few commitments in agriculture and NAMA in terms of market access and subsidies reduction, but some progress on trade facilitation and some advances on Services and Aid for Trade.¹⁸

“ African countries are involved in a number of regional and free trade agreements and negotiations ”

Other developments in international trade negotiations

In light of the recent suspension of the WTO negotiations and the ongoing EPA process, African countries have an ever greater interest in diversifying their export markets. They are involved in a number of regional and free trade agreements and negotiations. They are also benefiting from several major preferential schemes such as the USA's African Growth Opportunity Act (AGOA). Some African countries are also engaged in bilateral trade talks with other regions of the world. This section highlights the major recent developments related to these processes.

African regional integration

Fostering African regional integration has been a long-standing objective of the continent. The Treaty of Abuja Establishing the African Economic Community in 1991, (chapter 1) calls for a gradual continental integration process centred on the integration of the five subregions (North, West, East, Central and Southern). EPA processes are also aimed at supporting regional integration in Africa. Unfortunately, integration remains hampered by several obstacles including political and security factors, poor transport and communication infrastructure, a low degree of complementarity in the structures of production and the overly complex web of memberships across different RECs.

This latter problem, also known as the “spaghetti-bowl” situation is particularly acute in some subregions. In West Africa, the most advanced integration is by far that of the WAEMU while EPA negotiations are ongoing between EU and ECOWAS to which is associated Mauritania, a member of the Arab Maghreb Union (AMU). Cape Verde, a member of ECOWAS, has recently shown interest in negotiating a separate EPA with EU (www.acp-eu-trade.org). Most but not all of the COMESA members are negotiating EPAs under ESA. Egypt and Libya are COMESA members but are not part of the EPA negotiation process. However, there are long-term plans for a customs union among COMESA countries so this means that the ESA external tariff may have to be reviewed at a later stage.

Meanwhile, Kenya, the largest economy in Eastern Africa, is associated with Uganda and Tanzania in the East African Community (EAC) customs union. However, while the former two are negotiating EPAs with ESA, Tanzania is negotiating its EPA with SADC. SADC is planning to create a customs union by 2008, implying that Tan-

¹⁸ This is for example the case of Peter Sutherland, a former WTO Director-General, in his speech at Chatham House, Tuesday, 14 November, 2006.

zania would, in theory, be part of two customs unions. Moreover, within SADC, Southern African Customs Union (SACU) countries are associated in a customs union with South Africa, which has its own trade agreement with EU. South Africa has, however, been recently associated with SADC in the EPA negotiations, which should contribute to harmonization of positions. In the longer term, it seems that the obvious solution to the question of overlapping membership is the creation of a pan-African free trade area and then customs union, which is the stated objective of the Abuja Declaration.

Preferential trading schemes

Thirty-seven African countries are eligible under AGOA, which grants African countries quasi DFQF access to the US market. In 2005, US imports from SSA under AGOA totalled \$38.1 billion, up 44 per cent from the previous year, primarily due to an increase in imports of oil. US non-oil imports from Africa actually declined by 16 per cent to \$2.9 billion, mainly due to increased competition in the textile and apparel sector in the wake of the termination of the Multifibre Agreement. There were also some minor advances in traditional and non-traditional sectors such as chemical products, fruits, nuts, cut flowers and footwear.

Thirty-four African countries are LDCs and are therefore eligible for the EU's "Everything but Arms" scheme. Other non-LDC African countries are either beneficiaries of EU's GSP or are party to a bilateral free trade agreement with the EU (TDCA and Euro-Med process).

Other recent developments with regard to preferential schemes include the participation for the first time of a customs union – Mercosur - in the General System of Trade Preferences (GSTP). GSTP is a South-South initiative under which developing countries grant each other preferential market access.

Bilateral talks

Several African countries or groupings are also involved in bilateral trade negotiations in order to diversify their export markets and enhance their integration in the global economic system. For example, WAEMU countries are currently negotiating FTAs with several North African countries. USA and SACU are also engaged in free trade talks. South Africa is discussing a potential FTA with India and Mercosur countries. With the recent explosion of trade flows between Africa and China and India, several countries are carrying out bilateral trade negotiations with these two Asian nations.

With the suspension of WTO negotiations, several countries and regions have expressed an increased interest in enhancing their trade arrangements networks. EU has recently issued a declaration that it intends to negotiate agreements with coun-

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Several African countries or groupings are also involved in bilateral trade negotiations in order to diversify their export markets”

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tries in South and South East Asia, and revive its negotiations with Mercosur. The USA is also currently negotiating several agreements within the Western hemisphere and Asia. In this context, there is a risk that Africa will remain isolated from the wave of bilateral trade agreements, due to its low negotiating and manufacturing capacities.

Africa could in effect remain in a “spoke” situation while richer countries with more negotiating and production capacities are able to place themselves at the centre – or hub – of a network of trade agreements, thereby attracting more investments. In order to avoid such a situation, African countries must -with the support of the international community - continue to reinforce their trade capacities, both in terms of policy formulation and of negotiations and marketable products. They must also reinforce these capacities at the regional level in order to reap economies of scale.

3.2 Financing development: emerging issues and challenges for Africa

Trends in financing development¹⁹

The availability of finance as well as access to finance are important in accelerating economic development in Africa and in increasing the likelihood of the region meeting the MDGs. Since the 2000 United Nations Millennium Declaration, several studies have shown that Africa faces a serious financing gap and that if this gap is not filled, it will be unable to meet any of the goals (UNECA 2006a). Sachs et al. (2004) provide evidence suggesting that SSA would need approximately \$25 billion in additional ODA per year in order to meet the MDGs. In their view, the region is in a poverty trap and so needs a big push in financial aid in order to achieve sustained growth and poverty reduction. The March 2005 Report of the Commission for Africa also provides evidence for similar conclusions.

In recent years, efforts have been directed at finding ways and means to mobilize the additional funds needed to fill this financing gap through mobilization of both domestic and external resources.. In this section, trends in the various sources of development finance in the region are highlighted.

Enhancing domestic savings mobilization can increase investment

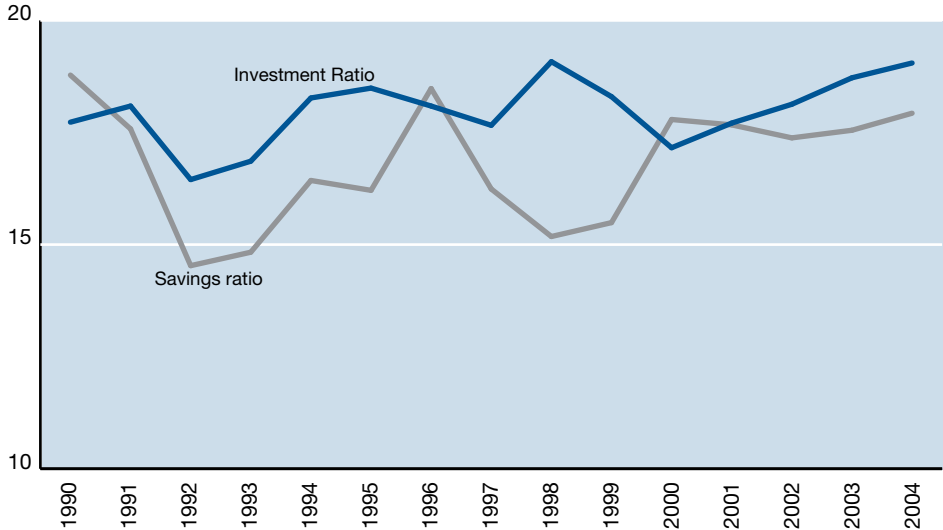
The mobilization of domestic savings will provide the much needed resources to finance investment in economic and social infrastructure in Africa. At the moment, investment ratios are very low in several countries. Relative to developing countries

¹⁹ UNECA (2006a) provides a detailed discussion on the volume and distribution of capital flows in Africa, as well as on their impact on development, including employment.

in Asia and Latin America, SSA has the lowest investment ratios. For example, over the period 2000–2004, domestic investment as a proportion of GDP was 18 per cent in SSA and 31 per cent in East Asia and the Pacific. As can be seen from figure 3.2, the domestic investment ratio in SSA is low because the domestic savings ratio is also low and the region has difficulties attracting sustained private capital flows. Overcoming this investment and savings constraint is a major challenge for African policymakers and the way in which it is resolved will to a large extent determine the region’s ability to achieve sustained economic growth in the medium to long term.

“The mobilization of domestic savings will provide the much needed resources to finance investment in economic and social infrastructure in Africa”

Figure 3.2
Investment and savings ratios for sub-Saharan Africa, 1990-2004



Source: World Bank 2006.

Historically, SSA saves less than 20 per cent of its GDP. Over the period 1990-1994, the average ratio of domestic savings to GDP was 16 per cent. There was a slight improvement in this ratio to 17 per cent over the period 2000-2004. However, this number is considerably below the average for East Asia and the Pacific (35 per cent), Latin America and the Caribbean (21 per cent), and Middle East and North Africa (26 per cent). Concerted efforts must be made by African leaders to increase domestic savings if the region is to experience sustained growth and increased likelihood of catching up with other developing regions.

The low aggregate savings ratio observed in SSA masks the wide differences in savings patterns across the countries. There are several countries with savings ratio comparable to those in East Asia. For example, over the period 2000-2004, five countries, Algeria, Botswana, Republic of Congo, Gabon and Nigeria, had savings ratios greater than 30 per cent. The ratios range from 32 per cent in Nigeria to 51 per cent in the Republic of Congo. These countries are oil-and or diamond-exporting nations that saw an increase in export revenue due to rises in the prices of these commodities.

“ A key challenge is how to translate these increases in domestic savings into productive investment ”

As a consequence, they may not be able to sustain the current increase in domestic savings, especially if there is a decline in the world prices of their exports.

Despite this uncertainty and vulnerability, it is worth noting that the increase in savings has enabled the five countries to increase their investment ratios, although the increase in the latter is not as large as in the former. Thus, a key challenge is how to translate these increases in domestic savings into productive investment, especially in non-oil and non-mineral activities, to ensure and increase prospects for sustained economic growth.

Eleven countries had negative savings ratios over the period 2000–2004. Since several of these are either in political crises or are post-conflict economies, it is not surprising that they had difficulties mobilizing domestic savings. For example, Liberia and Sierra Leone are just emerging from very disruptive political conflicts. However, countries such as Lesotho and Malawi had negative savings ratios although they did not have any equivalent political crises during the review period. Twenty-eight countries in the region had positive but low savings ratios, including South Africa, which has a developed financial system and is thus expected to be more able to mobilize sustainable domestic savings.

Official flows increasing

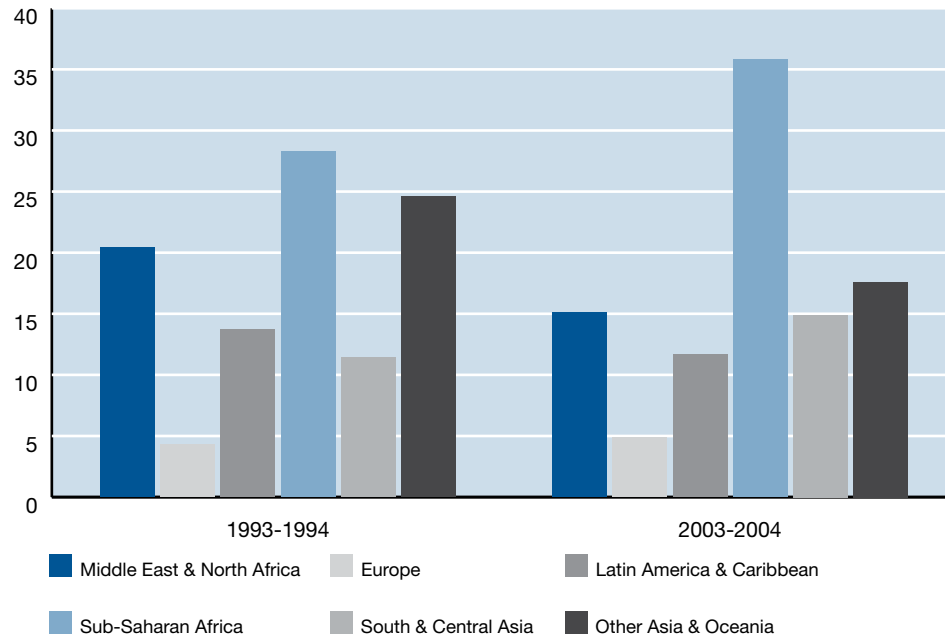
Over the past three decades, there has been a shift in the geographic distribution of official flows. In the 1970s, countries in Asia accounted for a large share of ODA. However, since the 1979 oil price shock, SSA accounts for a larger share of ODA. During 1993–1994, about 27 per cent of ODA went to SSA, while the other regions of the world got less than 25 per cent each. During 2003–2004, SSA received about 36 per cent of ODA (figure 3.3). This increase reflects recent efforts by OECD countries to scale up the volume of aid to Africa to enhance the prospects for meeting the MDGs.

Historically, official flows have played an important role in the economic development of countries. As is obvious from figure 3.4, total ODA to SSA has been on the increase since the 1970s. It reached a peak of \$19 billion in 1992 and declined for most of the 1990s. The trend in per capita ODA also follows a similar pattern. Since the 2000 Millennium Declaration, however, ODA to SSA has been on the increase again, reaching a peak of \$26 billion in 2004. That said, it should be noted that when expressed as a percentage of GDP, ODA to the SSA in 2004 was 5 per cent of GDP, which is still below the 6 per cent figure recorded in 1990.

Within the African region, the distribution of aid flows is uneven with a few countries accounting for a significant percentage of the aid flows. In 1990, the big recipients of the aid flows were: Egypt (\$US5.4 billion); Kenya (\$1.2 billion); Tanzania (\$1.2 billion); Morocco (\$1.1 billion); Ethiopia (\$1 billion); and Mozambique (\$1 billion). The other African countries received less than 1 billion dollars each. As a result of

Figure 3.3

Regional distribution of ODA (% of total disbursements)



“ Within the African region, the distribution of aid flows is uneven ”

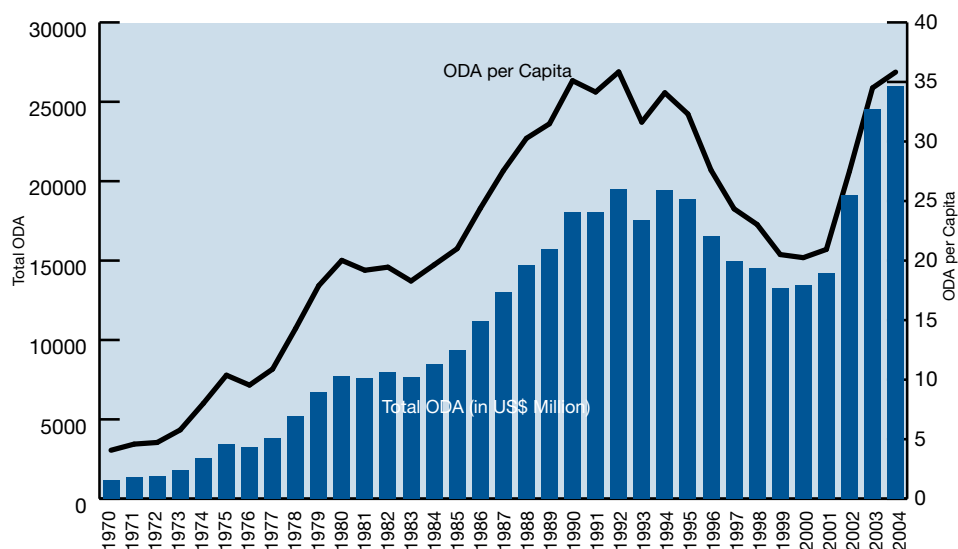
Source: World Bank 2006.

the new focus and priorities given to the region by G-8 countries, aid flows to several countries have increased. In 2004, the following ten countries received at least \$1 billion dollars of ODA: Angola, Ethiopia, Democratic Republic of Congo, Egypt, Ghana, Tanzania, Madagascar, Mozambique, Uganda, and Zambia. In per capita terms, the main recipients of ODA in the region in 2004 were: Cape Verde (\$282); Sao Tome and Principe (\$218); Seychelles (\$124); Swaziland (\$104); Zambia (\$94); and Senegal (\$92).

Since the launch of the Enhanced HIPC initiative in 1999, there has been a change in the composition of SSA aid commitments. The share of project aid in total aid to the region has decreased while that of debt forgiveness has increased from under 10 per cent in 1990-1994 to about 18 per cent over the period 2000-2003. Nonetheless, project aid still accounts for more than 60 per cent of SSA aid commitments (Gupta et al. 2006). Given the relatively low domestic savings ratios of SSA countries, the region will continue to rely on access to ODA as a major source of financing development, unless drastic steps are taken to boost private capital flows and mobilize domestic savings.

“ A large part of recent private capital flows to SSA is in the form of equity as opposed to debt ”

Figure 3.4
ODA to sub-Saharan Africa (\$US million)



Source: World Bank 2006.

Private capital flows

Private capital flows is another key source of external finance in SSA (UNECA 2006a). In the late 1990s, it was a more important source of external finance to the region. In 1998 and 1999, net private flows to SSA were 13.7 and 16.7 billion dollars respectively. Over the same period, net official flows to the region were 10.6 and 10.3 billion dollars respectively. Net private capital flows to SSA were low over the years 2000–2002 due in part to the impact of the Asian financial crises on investor attitudes towards foreign investment. Private capital flows to the region has increased fast since 2003 and they exceeded net official flows in 2005 (table 3.2).

A large part of recent private capital flows to SSA is in the form of equity as opposed to debt. In 2005, net equity flows accounted for 86 per cent of net private capital flows to the region. Furthermore, between 1998 and 2002, the net debt flows were negative, reflecting the fact that, during this period several countries in the region were more interested in servicing existing debt than in accumulating further debt. The decline in the debt-equity ratio of private capital flows to SSA is a welcome development as it should limit the incidence of debt overhang in several countries. It should also be noted that there has been a shift in emphasis from short- to medium- and long-term debt, which will help to avoid the maturity mismatches that have been a feature of debt in the region.

Recent equity flows to SSA have also been in the form of FDI inflows (table 3.2), as opposed to portfolio equity inflows that are highly volatile and often leave countries

Table 3.2**Sources of external finance in sub-Saharan Africa 1998-2005 (\$US billion)**

	1998	1999	2000	2001	2002	2003	2004	2005
Net Private Flows	13.7	16.7	9.9	12.1	6.3	15.8	20.7	28.5
Net equity flows	15.5	18	10.7	14	9.1	14.3	18	24.7
FDI inflows	6.9	9.0	6.5	15.0	9.5	13.6	11.3	17.6
Portfolio equity inflows	8.7	9.0	4.2	-1.0	-0.4	0.7	6.7	7.2
Net debt flows	-1.8	-1.3	-0.7	-2	-2.8	1.5	2.8	3.8
Medium/long term	-1.3	-0.7	0.4	0.1	-1.0	2.5	1.7	2.3
Short term	-0.5	-0.6	-1.1	-2.1	-1.8	-1.0	1.1	1.5
Net Official Flows	10.6	10.3	10.7	10.7	16.6	23.3	25.1	25.2
Bilateral aid grants (excludes technical cooperation grants)	10.1	9.9	10	10	14	22	24.2	28.4
Net debt flows	0.5	0.4	0.7	0.6	2.6	1.2	0.8	-3.2

Source: World Bank 2006.

vulnerable to sudden reversals and investor sentiments. The increasing reliance of African countries on FDI rather than debt should be encouraged because it will help to avoid debt accumulation with the associated debt service burden. FDI is also a good source of financing development because it has a potentially important role to play in stimulating growth and development. African countries should put more effective policies in place to attract FDI and increase their share of development finance from this source. Table 3.3 shows that the region currently attracts less FDI than most developing countries. In 2005, FDI to SSA represented about 7 per cent of FDI to all developing countries.

Table 3.3**Net inward foreign direct investment across regions (\$US billion)**

Group	1997	1998	1999	2000	2001	2002	2003	2004	2005
All developing countries	168.7	172.4	183.3	168.8	176.9	160.3	161.6	211.5	237.5
East Asia and Pacific	62.1	57.8	50.8	44.3	48.5	57.2	59.8	64.6	65.3
Europe and Central Asia	24.6	27.4	29.8	30.2	32.7	34.9	35.9	62.4	75.6
Latin America and the Caribbean	66.7	74.1	88.3	79.3	71.1	48.2	41.1	60.8	61.4
Middle East and North Africa	2.1	2.7	2.4	4.1	3.4	3.7	5.6	5.3	9.1
South Asia	4.9	3.5	3.1	4.4	6.1	6.7	5.6	7.2	8.4
Sub-Saharan Africa (as % of FDI to develop- ing countries)	8.3	6.9	9	6.5	15	9.5	13.6	11.3	17.6
Angola	4.9	4.0	4.9	3.9	8.5	5.9	8.4	5.3	7.4
South Africa	0.4	1.1	2.5	0.9	2.1	1.7	3.5	1.4	1.5
South Africa	3.8	0.6	1.5	1	7.3	0.7	0.8	0.6	6.3

Source: World Bank 2006.

“ In SSA, remittances are becoming increasingly important ”

The problem of capital flight

The analysis of capital flows to and from Africa reveals a curious paradox. On the one hand, African countries have accumulated large volumes of debt, presumably to fill their resource gap and finance their development needs. On the other hand, as discussed in-depth in UNECA (2006a), the continent continues to experience heavy financial haemorrhage in the form of capital flight, some of which is financed by borrowed funds. This loss of capital deprives Africa of a sizable portion of the very resources it needs for development financing.

Remittances

In economies with very low domestic savings and poor access to international capital markets, migrant workers' remittances can play a vital role in development finance. In several regions of the world, this is indeed growing at an unprecedented rate. In 2004, it accounted for 1.5 per cent of GDP in SSA, 1.7 per cent in East Asia and Pacific, 2 per cent in Latin America and the Caribbean, 4.1 per cent in Middle East and North Africa, and 3.6 per cent in South Asia. In 2005, the total value of remittances from all regions was \$232 billion which is marginally below the total value of net inward FDI to all developing countries (\$237 billion) for the same year. The true value of remittances may be larger given the fact that some remittances are transmitted through informal channels and so are not reflected in official statistics.

In SSA, remittances are becoming increasingly important, with remittances in 2004 at about 1.5 per cent of GDP. Although this is lower than the 5 per cent figure recorded for ODA in the same year, it is clearly not an insignificant source of financing. UNECA (2006) discusses the advantages and disadvantages of remittances relative to other flows. In terms of monetary value, the magnitude of remittances to SSA is still relatively small compared to receipts by other developing regions. Estimates available for 2005, suggest that SSA received \$8.1 billion in remittances compared to \$43 billion and \$42 billion for East Asia and the Pacific and Latin America and the Caribbean respectively. The region also received less from this source than countries in South Asia and Middle East and North Africa.

That said, it should be noted that the low figure reported for SSA may be due to the fact that relative to other regions, it transfers more remittances through informal channels. It is also due to the fact that financial institutions in the region are less developed than in the other regions and so it is more difficult and costly to transfer remittances.

Migration is also a source of concern because of the negative impact of brain drain, a phenomenon that reflects the failure of African economies to absorb human capital.

In response, governments need to design strategies not only to build human capital but also to retain it.²⁰

From Monterrey to Gleneagles

African countries and their development partners have recognized the crucial role of finance in development and are making serious efforts to mobilize both international and domestic resources. However, they face serious challenges in their efforts to use development finance as an effective instrument for development. These challenges include:

- Finding an effective and sustainable solution to the external debt crises facing several African countries so as to release resources for development finance;
- Attracting sustained private capital flows, including remittances, and ensuring that they are in sectors with high value-added and employment impact;
- Improving domestic resource mobilization through increased savings, higher tax revenue, and reduction of capital flight;
- Improving the effectiveness and absorptive capacity of foreign aid; and
- Using international trade as a vehicle for resource mobilization.

The Monterrey Consensus, adopted by Heads of State and Government at the International Conference on Financing Development in March 2002, was the first comprehensive and global attempt to address these challenges. It was also the first time that development finance and related issues became the main focus in international financial discussions. In the Monterrey Consensus, world leaders noted with concern the financial gap to be filled in order to attain the MDGs. They called for a new partnership between developed and developing countries and committed themselves to mobilizing domestic financial resources, attracting international capital flows, promoting international trade as an engine for development, increasing international financial and technical cooperation for development, sustainable debt financing and external debt relief, and enhancing the coherence and consistency of international monetary, financial and trading systems for development.

Although the Monterrey Consensus highlighted the importance of aid harmonization for effective development outcomes in recipient countries, there were no clear guidelines and commitments from donors to ensure that the objectives would be achieved, until the High-Level Forum on Harmonization held in Rome in February 2003. In the ensuing Rome Declaration on Harmonization, donors acknowledged the need to reduce transactions costs of aid delivery in recipient countries. They also stressed the need for country ownership of aid programmes and for good practices,

“ Governments need to design strategies not only to build human capital but also to retain it ”

²⁰ See *Journal of African Economies*, December 2006, Volume 15, Supplement 2, for a detailed discussion of this topic.

““ Donors are committed to making their actions more harmonized, transparent and collectively effective ””

standards and principles in implementing development cooperation. Against this background, donors committed to providing development assistance in accordance with partner country priorities, implementing good practices, standards and principles in development assistance delivery and management, adapting harmonization efforts to the country context, and harmonizing donor policies and procedures.

As a follow-up to the Rome Declaration on Harmonization, an international roundtable on Managing for Development Results was held in Marrakech in February 2004. The outcome of this meeting was the Joint Marrakech Memorandum on Managing for Development Results endorsed by the the African Development Bank (AfDB), Asian Development Bank (AsDB), Inter-American Development Bank (IADB), European Bank for Reconstruction and Development (EBRD), the World Bank, and the Chairman of the Development Assistance Committee of the Organization for Economic Cooperation and Development (DAC/OECD). In the Memorandum, they committed to fostering a global partnership and approach on managing for development results and aid effectiveness.

While the Monterrey Consensus, the Rome Declaration and the Marrakech Memorandum defined the main objectives of the aid-effectiveness agenda and led to an expansion in activities aimed at improving the effectiveness of aid delivery, the Paris Declaration on Aid Effectiveness of 2005 represents the first bold attempt by donors and developing countries to take monitorable actions to reform the way aid is delivered and managed. The latter declaration was the outcome of the High-Level Forum on Aid Effectiveness held in Paris, 28 February – 2 March 2005.

The 2005 Paris Declaration on Aid Effectiveness focused on five key areas, namely, ownership, harmonization, alignment, managing for results, and mutual accountability. Regarding ownership, the Declaration stressed the need for partner countries to exercise effective leadership over their development policies and coordinate development actions. On alignment, donors made commitments to base their overall support on partner countries' national development strategies, institutions and procedures. They also made commitments to provide reliable indicative commitments of aid over a multi-year framework and to disburse aid in a timely and predictable fashion according to agreed schedules. Reducing the proportion of aid that is tied is also a key aspect of this area of the Declaration.

In the area of harmonization, donors committed to making their actions more harmonized, transparent and collectively effective. On managing for results, they made commitments to manage and implement aid in a way that focuses on the desired results and uses information to improve decision-making. Finally, regarding mutual accountability, donors and developing countries made commitments to enhance mutual accountability and transparency in the use of development resources, as both parties are accountable for development outcomes. An important feature of the Paris Declaration was that indicators of progress and targets were set for each of the five areas to increase transparency in monitoring the implementation of agreed commitments.

The G-8 Summit in Gleneagles in July 2005 added momentum to the commitments made by world leaders in Monterrey to increase aid flows and reduce the burden of external debt on developing countries, to enhance their prospects for meeting the MDGs. The Declaration issued also recognized the need for substantial increase in ODA to consolidate and build on recent advances in Africa and to stimulate growth to reduce aid dependency. On aid, the Declaration indicated that the commitments of G-8 countries and other donors would increase ODA to all developing countries by \$50 billion a year by 2010 compared to 2004. Half of this increase would go to Africa, representing more than a doubling of aid to Africa compared to 2004. On debt, the G-8 agreed to a proposal to cancel 100 per cent of the outstanding debts of eligible HIPC countries to the IMF, International Development Association (IDA) and African Development Fund, and to provide additional resources to ensure that the capacity of the international financial institutions was not reduced. They also re-affirmed their commitments to the Paris Declaration on Aid Effectiveness and stressed the need for developing countries and their governments to take the lead on development and to be accountable for their actions.

Efforts have been made by both developed and developing countries to hold donors accountable for the pledges and commitments made to developing countries

Monitoring implementation of commitments

Since the Monterrey Consensus was adopted, efforts have been made by both developed and developing countries to hold donors accountable for the pledges and commitments made to developing countries. In this section, we examine the extent to which donors have lived up to their promises and pledges to Africa in three key areas: scaling-up of aid; improving aid effectiveness; and debt relief or debt cancellation. Due to data limitations, some parts of our analysis will focus on commitments made by the G-8 countries.

Compliance with regard to aid quantity

The key target that donors have set for themselves on aid is to attain an ODA to GNI ratio of 0.7 per cent. Since this target was set in 1969, only a few countries have met it. In 2004, the average ratio for DAC members was 0.26 per cent. That said, Denmark, Luxembourg, the Netherlands, Norway, and Sweden have met the target. Countries such as Belgium, France, Portugal, and Switzerland have also made significant progress although they are yet to meet the target. Among DAC members, Japan, the USA, and Italy have the lowest ODA/GNI ratios - below 0.20 per cent in 2004.

The G-8 Research Group at the University of Toronto, Canada, has developed a very useful methodology for assessing the extent to which G-8 countries comply with the commitments made at their annual summits. The assessment uses a three-category scoring method: Full or near full compliance with commitment results in a score of +1; Complete or nearly complete failure to implement a commitment results in a

““ The overall effectiveness of any form of aid depends to a large extent on its quality ””

score of -1; and an “inability to commit” or “work-in-progress” leads to a score of 0. An inability to commit refers to factors outside the executive branch that impedes the implementation of a commitment while “work-in-progress” refers to an initiative that has been launched by a government but is not yet near completion.

Using this scoring methodology, the performance of the G-8 countries in terms of meeting the commitments made to Africa and the developing world on scaling-up aid falls into the category “work-in-progress.” This is because the G-8 countries have only met part of the commitments made on scaling-up aid to developing countries and to Africa in particular. One of the reasons why these G-8 countries as a group have not fully complied with their commitments to scale-up aid to Africa is that some of them have not made much progress in following through on their commitments to double ODA to Africa. The USA, one of the big donors, has made some progress in complying with its commitments although it is not enough to double aid to Africa by 2010. In contrast, Canada, France, Germany, the United Kingdom and EU have all fully complied with their commitments in this area and so have a score of +1.

Compliance with regard to aid effectiveness

The quantity of aid is important but the overall effectiveness of any form of aid depends to a large extent on its quality. Consequently, in discussions on aid, it is now popular to talk about the quality of aid and aid effectiveness in recipient countries. There are various factors that determine the overall quality of aid and hence its effectiveness. These include the proportion of aid that is tied, the extent to which aid is in the form of grants or concessional loans, the proportion of aid that goes to poor as opposed to relatively rich countries, the state of governance in recipient countries, and the administrative or transactions costs associated with aid.

Table 3.4 presents the percentage of bilateral ODA from DAC member countries to LDCs that is untied. To the extent that more than half of the LDCs are in Africa, the table captures the region’s experience with tied aid as well. It is clear from the table that there has been a reduction in the percentage of aid from DAC member countries that is tied. Over the period 1999-2001, 55 per cent of total DAC aid to LDCs was untied. In 2004, the figure rose to 68 per cent.

Looking at individual DAC countries, however, there are wide differences in performance. Countries such as Finland, Ireland, Luxembourg, Norway and the United Kingdom have successfully moved away from tied to untied aid. The USA, New Zealand, and Greece have a very low ratio of untied aid to total aid and so are at the bottom of the list. More progress needs to be made by these countries, especially the USA, if the DAC average is to improve significantly.

Table 3.4**Proportion of bilateral aid to LDCs that is untied**

	1999-2001 (average)	2004
Australia	0.42	0.91
Austria	0.34	0.68
Belgium	0.49	0.99
Canada	0.40	0.76
Denmark	0.77	0.80
Finland	0.69	1.00
France	0.54	0.85
Germany	0.43	0.66
Greece	...	0.41
Ireland	1.00	1.00
Italy	0.30	0.80
Japan	0.76	0.81
Luxembourg	...	1.00
Netherlands	0.86	0.96
New Zealand	...	0.36
Norway	0.99	1.00
Portugal	0.42	0.99
Spain	0.25	0.95
Sweden	0.69	0.98
Switzerland	0.84	0.95
United Kingdom	0.62	1.00
United States	0.01	0.03
Total DAC	0.55	0.68

Source: OECD 2006a.

Regarding the composition of aid, there has also been progress in this area. The share of grants in total ODA has increased over the years. For DAC countries, the average was roughly 49 per cent over the period 1980-1984 (Gupta, Pattillo, and Wagh 2006). For the 2003-2004 period, the average was 90 per cent. In DAC countries such as Australia, Austria, Canada, Greece, Ireland, Luxembourg, Netherlands, and New Zealand, grants represent 100 per cent of ODA. At 60 per cent, Japan has the lowest ratio of grant to total ODA. An improvement is needed in this area if Japan is to catch up with the other donors. The increasing share of grants in total ODA is a welcome development in African countries. Several countries are already heavily indebted and are looking for ways to reduce their debt burden. Reducing their proportion of loans in total ODA prevents further accumulation of debts.

“The increasing share of grants in total ODA is a welcome development in African countries”

Compliance with regard to debt relief

Debt relief is one area in which G-8 countries and other donors have made significant progress in meeting their commitments. At Gleneagles, donors promised that all debts owed by eligible HIPC to IMF, IDA, and the African Development Fund would be cancelled. The G-8 Research Group has also examined the extent to which member countries have honoured the commitments made in Gleneagles on debt relief and found that they have fully complied with all commitments in this area.

The outstanding performance of the G-8 in the area of debt relief is due in part to their commitment and support to the HIPC initiative and to the MDRI. The HIPC initiative was established in 1996 to reduce the debt burden of eligible countries. As a result of slow progress in attaining the debt reduction objective of the initiative, an enhanced version was launched in 1999 with relatively less restrictive eligibility criteria. As of July 2006, 40 countries had either qualified or were currently under consideration or were potentially eligible for debt relief under the initiative. Of the 40 countries, 19 have reached the completion point, 10 have reached the decision point and 11 are pre-decision point countries. In addition, of the 19 countries that have reached the completion point, 15 are in Africa.

In addition to supporting debt relief under the HIPC initiative, G-8 countries were also behind the launching of MDRI in 2005 to reduce the debt burden of eligible HIPC countries and provide additional resources to help them meet the MDGs. Under the MDRI, the IDA, IMF and AfDB would provide 100 per cent debt relief on eligible debt to countries that had completed the HIPC process. Although these three institutions are responsible for delivery of debt relief under MDRI, each institution has its own guidelines on how it will implement the agreements. For example, while only HIPC countries are eligible for MDRI provided by IDA and AfDB, the IMF also considers non-HIPC countries with per capita income of \$380 or less.

Furthermore, for IMF and AfDB, eligible debt is outstanding debt as of end-2004. For IDA, it is outstanding debt as of end-2003. As of mid-July 2006, committed assistance to African countries under the HIPC initiative and assistance delivered or expected to be delivered under MDRI was \$50 billion (IDA and IMF 2006). Of this amount, \$34 billion was committed under the HIPC initiative and \$15.9 billion under MDRI. Within the HIPC allocation, \$21.6 billion represented assistance to the 15 African countries that reached the completion point as at mid-July 2006, while \$12.5 billion represented assistance to 10 African countries that have reached the decision point.

In summary, while donors have made significant progress in meeting commitments on debt relief, they have made relatively less effort in fulfilling the pledges made on scaling-up aid and improving aid effectiveness. Urgent actions need to be taken in these areas to enable African countries obtain the pledged resources needed to attain the MDGs.

Emerging issues on aid and debt

In recent years, there have been discussions on the impact of new aid and debt initiatives on recipient countries. There is no doubt that African countries need more aid flows to enable them to increase the likelihood of achieving the MDGs. However, more aid flows will also impose serious challenges on African economies, and policy-makers must prepare themselves to deal with these challenges if they are to maximize the benefits of aid and minimize the costs. Several papers have tried to identify the challenges facing African countries as a result of the decision by donors to scale-up aid to the region (Bourguignon and Sundberg 2006; Heller 2005). These challenges include how to increase the absorptive capacity for aid in recipient countries and how to ensure that aid does not lead to loss of competitiveness through real exchange rate overvaluation. In this section, the economic consequences of scaling-up aid and debt relief to African countries are examined.

“ More aid flows will also impose serious challenges on African economies ”

Economic impact of aid

The impact of the scaling-up of aid has been a major preoccupation of researchers and policy-makers in recent years as reflected in the growing literature on the subject. Several papers have addressed the main issues including the “Dutch disease” problem, the effect on growth, the impact on fiscal sustainability and the issue of predictability of aid.

Dutch disease

The Dutch disease effect is probably the most widely discussed potential adverse effect of an increase in aid flows. The idea is that in a small open economy where prices of traded goods are determined on the world market, an increase in aid inflows may lead to an increase in the price of non-traded goods resulting in a real exchange rate appreciation. This appreciation of the real exchange rate will have a negative impact on the competitiveness of the economy. The assumption here is that a large part of the inflows is spent on non-traded goods. In addition, the Dutch disease effect and the impact of aid flows on relative prices and exchange rates are not automatic and depend on several factors including the share of aid spent on productive investment relative to that spent on consumption of final goods. If the aid is financing productive investment, it will improve productivity, enhance growth and have less impact on prices and on the real exchange rate.

The evidence from empirical studies on the impact of scaling-up aid on the real exchange rate and relative prices are mixed. In a recent study of 13 African countries by Chowdhury and McKinley (2006), eight countries had a positive correlation between net aid inflows and real exchange rates, suggesting that increased aid flows were accompanied by depreciation, rather than appreciation of the real exchange rate.

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If the aid is financing productive investment, it will improve productivity, enhance growth and have less impact on prices and on the real exchange rate
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In five countries, the correlation was negative. For the link between the aid inflows and the inflation, the study suggested that the correlation for all the countries was positive, indicating that increasing aid is associated with an increase in inflation, and this has consequences for competitiveness of the economy. The potential for Dutch disease is a real concern for African economies. However, the risk could be mitigated by increasing the level of aid directed to productive investment, to improve productivity and to help the economy respond to pressure from the demand side.

Aid and growth

An important and compelling reason for increasing aid to Africa is to accelerate growth and increase the likelihood of attaining the MDGs in the region. Assessments of the performance of African countries show that it would be difficult for them to achieve the MDGs if current trends continue. High and sustained growth is needed to reduce poverty in African economies. Thus, it is important to know if scaling-up aid will accelerate growth in Africa. This issue has been discussed at length in several papers (Clemens et al. 2004; Burnside and Dollar 2000; Easterly et al. 2003).

There are three main views on the relationship between aid and growth. The first is that aid has a positive effect on growth, but with diminishing returns as the volume of aid increases. The channels through which aid has a positive effect on growth include: augmenting savings and making it possible to finance investments; increasing worker productivity through investments in health or education; and providing a channel for the transfer of technology from rich to poor countries. The second view on the link between aid and growth is that aid has no effect on growth. Arguments put forward to support this view are that aid is often wasted, supports bad governments, reduces domestic savings, and undermines private sector incentives for investment. In addition, it is often argued that recipient countries do not have the capacity to absorb large amounts of aid. The third view on the relationship between the two variables is that aid has a conditional relationship with growth. It works best in countries with good institutions and policies. For example, a recent study on aid to African countries showed that in 11 “good performance countries” high growth is linked to high aid flows (Bourguignon et al. 2005; World Bank 2005).

Aid and fiscal sustainability

The debate on the challenges of increasing aid has raised the issue of fiscal sustainability (Heller 2005). One of the key concerns here is the impact of increased aid on fiscal attitudes as well as on the efforts of the recipient countries to collect tax and increase government revenues. There is a fear that an increase in aid will not encourage countries to increase their fiscal revenues. However, these views are not supported by the findings of recent studies indicating that the relation between aid

and tax collection is very weak (Bourguignon et al. 2005). Another notable issue is that of public expenditure management. It has been argued that if higher aid inflows are used to finance labour-intensive public services (e.g. schools or clinics) that have large recurrent costs, then if there is an unexpected fall in aid levels, the ability of the government to continue with the provision of these services may be limited. Consequently, effective fiscal planning is crucial for economies dependent on aid flows.

“Aid volatility contributes to the weak impact of aid on growth and development”

Volatility of aid

Aid recipients have to deal with the uncertainty surrounding both aid commitments and disbursements. This concern is serious because recipient countries have to formulate and implement medium-term development strategies and it is difficult to do this effectively if they are not certain about the timing and amount of aid that would be available to them over the time horizon considered. The uncertainty surrounding aid is also a problem because studies have shown that it can have negative consequences for output (Lensink and Morrissey 2000). Added to the volatility problem is the inefficiency resulting from conditions and procedures associated with aid delivery. In several countries, the multiplicity of donor programmes and their poor alignment with recipient government priorities often lead to inefficiencies. This inefficiency contributes to the weak impact of aid on growth and development.

Provision of social services

Aid is often used to finance the provision of social services, especially health and education. The idea is that these investments have a positive effect on productivity and hence on growth and poverty reduction. The correlations between aid and health and education expenditures for African countries indicate that there is a strong, positive and statistically significant relationship between health expenditure per capita and aid per capita. This relationship holds for both contemporaneous and lagged aid. The correlation coefficients are 0.28 and 0.33 for contemporaneous and lagged aid, respectively. With regard to education, the results indicate that there is no statistically significant relationship between aid per capita and the share of education in total government expenditure. Despite the need to use aid for increasing provision of social services, it is important that this is not done in a way that reduces investments in infrastructure because this is likely to have a long-run negative impact on growth in the region.

Economic impact of debt relief

Debt relief is also one of the major components or sources of the expected increase in resources to African countries to help them finance activities and actions needed to meet the MDGs. As at mid-July 2006, total HIPC initiative assistance commit-

ment and assistance delivered or expected to be delivered to African countries under MDRI was about \$50 billion. If donors follow through on their commitments, this will represent a significant inflow of resources to eligible African countries. It will also present challenges to these countries, including:

“ One of the main objectives of debt relief is to free up resources for financing social programmes that are expected to have significant impact on poverty reduction ”

- How to manage the additional resource flows emanating from debt relief and ensure that they are effectively used for poverty reduction;
- How to increase domestic absorptive capacity to absorb these inflows and ensure that they do not result in real exchange rate appreciation and a reduction in export competitiveness; and
- How to ensure that current debt relief does not encourage excessive new borrowing and the accumulation of further debt.

As indicated earlier, one of the main objectives of debt relief is to free up resources for financing social programmes that are expected to have significant impact on poverty reduction. In this section, the links between debt relief and social expenditure, inflation and growth are examined.

Debt relief and social expenditure

One of the compelling arguments for debt relief is that it will free up resources for financing social programmes that are vital for alleviating poverty. There is a general belief that an increase in expenditure on education and health will have positive effects on productivity and on poverty reduction. Despite the popularity of these views, it is not clear that an increase in debt relief will actually boost social expenditure. Recent empirical studies have tried to examine the extent to which debt relief leads to an increase in social expenditures. Chavin and Kraay (2005) examined the link between debt relief and social expenditure. They found no evidence of a statistical relationship between debt relief granted over 1989-1993 and the share of government expenditure on health and education during 1994-1998.

That said, they also found that debt relief over the period 1994-1998 was associated with an increase in the shares of education and health in total spending during 1999-2003, although the evidence is not robust. In terms of country-specific evidence, Nannyonjo (2001) argues that in Uganda, debt relief had a positive impact on social expenditure in the late 1990s, particularly in the education and health sectors. Dessy and Vencatachellum (2006) have also examined this issue using African data. They found that debt relief had a positive impact on the share of education and health in total spending over the period 1989-2003.

Debt relief and growth

One of the concerns about the high external debt of poor countries is that it stifles growth and so makes it even more difficult for a country to generate enough resources

to repay its existing stock of debt. High debt can reduce growth through its negative impact on investment. It can also reduce growth by reducing the incentives of governments to adopt structural reforms. Several attempts have been made to examine the link between debt and growth. However, until recently, most of the studies use data for both emerging markets and low-income countries without taking into account the fact that the heterogeneity between emerging markets and low-income countries has implications for the relationship between debt and growth. Unlike emerging markets, low-income countries have very limited access to international capital markets. In addition, they have relatively different economic structures and rely on foreign aid. These differences suggest that the relationship between debt and growth will differ across the two groups of countries.

In a recent study, Pattillo et al. (2002) found that external debt has a negative effect on growth after a critical threshold for debt is reached. In particular, they found that when the net present value of debt is greater than 160-170 per cent of exports and 35-40 per cent of GDP, external debt stifles growth. With regard to the link between debt relief and growth, Clements et al. (2005) present evidence suggesting that debt relief under the HIPC initiative will add 0.8-1.1 percentage points to the annual per capita GDP growth rates of the countries in their sample. These findings support the widely held view amongst African policymakers that debt relief will increase the prospects for growth and development in the region.

“*Debt relief will increase the prospects for growth and development in the region*”

3.3 Conclusion

It is expected that the recent renewed global attention to the problems of developing countries will contribute to redressing the trends towards marginalization of these countries. This renewed attention could have a positive impact on African economies, allowing them to consolidate the positive growth performance recorded over the past years. This interest in the problems of developing countries was exhibited in the Doha Round of negotiations initiated in 2001, which brought development issues to the centre of the debate in the negotiations. The interest in development was also illustrated in the Monterrey Consensus with a global commitment to increase aid and cancel debt for developing countries.

This chapter has highlighted these new trends in global attention against the problems of developing countries in general and African countries in particular. The chapter has also underscored the delays and gaps between commitments and their effective implementation.

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