

# Overview—Accelerating the Pace of Development

The economic performance of African economies fell short of expectations in 2002, with growth slowing from an average of 4.3% in 2001 to 3.2% in 2002. In 2002, of the 53 countries in Africa, only 5 achieved the 7% growth rate required to meet the Millennium Development Goals. Of the others, 43 registered growth rates below 7%, and 5 registered negative growth.

The modest overall performance in 2002 reflects the weaker global economy and a slower than expected rebound in world trade. Africa's economic performance was weakened by drought and HIV/AIDS in various parts of southern and eastern Africa, and political and armed conflicts in the Central African Republic, Côte d'Ivoire, Madagascar, and Zimbabwe.

But well-managed countries, with solid reform agendas and a record of stability and good governance, performed well. Mozambique had growth of 12%—among the fastest in Africa. Other well-managed reformers—Ethiopia, Rwanda, and Uganda—grew at 6% or more.

## Highlights for 2002

*World trade beginning to recover.* World trade began to recover from a decline in 2001, with the seasonally adjusted value of U.S. merchandise exports in the first half of 2002 growing at an annualized 7.2% over the first half of 2001. Other regions have not shown such strong improvements.

*Commodity prices on an upward trend.* Commodity prices recovered strongly as global economic activity picked up. The rise in crude oil prices will slow growth in Africa but will loosen the financing constraints for oil-exporting countries. Rising cocoa prices could benefit producers such as Côte d'Ivoire and Ghana. Despite the upward trend, some commodities have had stagnant or declining prices, notably coffee, tea, and cotton. That will reduce the foreign exchange earnings of such countries as Ethiopia, Kenya, and Uganda.

*Foreign direct investment down.* Foreign direct investment inflows to Africa declined by \$6 billion, in line with the downward trend worldwide, a result of the faltering global economic recovery. Foreign direct investment in Africa continued to be hampered by



“Africa’s growth slowed from an average of 4.3% in 2001 to 3.2% in 2003”

weak governance, poor infrastructure and institutions, and ongoing conflicts in a large number of countries.

*Privatization still slow and reluctant.* An important source of foreign direct investment is privatization, yet progress on privatization has been slow, with activity concentrated in a handful of countries: South Africa, Ghana, Nigeria, Zambia, and Côte d'Ivoire. Of the 2,300 privatizations in Sub-Saharan Africa over 1991–2000 only 66 were of higher value and economically significant enterprises. The vast majority were sell-offs of ailing or small firms. So far, privatization has not boosted investment in Africa.

*Pledges made to increase official development assistance.* The UN Conference on Financing for Development in Monterrey in March 2002 elicited pledges to increase official development assistance (ODA) over the medium term from its current level of \$50 billion for all aid recipients. Promises from the European Union (EU) and United States alone would generate an extra \$12 billion a year from 2006 onwards for all developing countries, with much for Africa. That is a welcome improvement, though well short of the extra \$50 billion a year required globally to reach the Millennium Development Goals.

*But there are worrying trends.* ODA flows to Africa are usually analyzed in the aggregate, with little attention to particular sectors, masking worrying trends. For the “production sectors”—agriculture, manufacturing, trade, banking, and tourism—ODA declined from 17% in 1975–80 to 11% in 1995–2000. In absolute terms, bilateral ODA flows to African economies have dropped in the last decade, with the exception of flows to education.

*Capital flight, equivalent to Sub-Saharan Africa's GDP . . .* New data for 30 countries shows that capital flight over the past 27 years amounted to about \$187 billion. Including imputed interest earnings, the accumulated stock of capital flight was about \$274 billion at the end of 1996. Angola, Cameroon, Côte d'Ivoire, the Democratic Republic of Congo, and Nigeria have the highest stocks of capital flight. Five of the 30 countries—Benin, Mali, Niger, Senegal, and Togo—exhibited “negative” stocks of flight capital, indicating that their recorded capital inflows exceed recorded uses of foreign exchange.

*. . . is apparently debt-driven.* The data show that roughly 80 cents on every dollar that flowed into Africa from foreign loans flowed back out as capital flight in the same year, suggesting widespread capital flight fuelled by debt. And every dollar added to the stock of external debt added roughly three cents to the annual capital flight in all subsequent years. So, debt relief strategies will bring long-term benefits to African countries only if accompanied by measures to prevent a new cycle of external borrowing and capital flight.

*Saving and investment still low.* A key constraint to growth in Africa remains its low rates of saving and investment. And even countries that achieved high rates failed to reap the benefits in growth, suggesting low efficiency of resource use.

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*Trade and current accounts in deficit.* Eleven countries had unsustainable current account deficits of more than 5% of GDP in 2002, while eight had surpluses, the result of higher export revenues. (The rest ran deficits of less than 5%). Several initiatives, notably the U.S. African Growth and Opportunity Act (AGOA), should help to increase African exports. Improving access for agricultural products to developed countries remains a key challenge.

*Fiscal policy continuing to improve.* Overall fiscal discipline improved. But fiscal profligacy remains a problem, with a number of countries having deficits of more than 3% of GDP. In some countries, notably Nigeria, this was driven by increased spending in the run-up to elections. In others, such as Angola, spending pressure came from post-conflict reconstruction needs. True, there are some strong performers, but much more needs to be done to improve fiscal management across the continent.

*Monetary and exchange rate policies sound.* Monetary and exchange rate policies were fairly sound in 2002, with 11 countries holding inflation under 3% as a result of prudent policies. But some countries had massive price increases because of conflict and political crises. The CFA franc appreciated against the dollar, which could hurt the competitiveness of countries with high trade exposures, such as Mali and Senegal. North African exchange rates were generally stable.

*Agriculture and food security in crisis.* Agriculture in many countries suffered from the adverse climatic conditions in 2002. Flooding hit food production in Algeria, Kenya, and Senegal. Countries in Eastern and Southern Africa faced a food crisis because of drought. In Ethiopia a quarter of the population needs food aid; in Zimbabwe close to half.

*Country efforts to reduce poverty intensified.* Despite the weaker than expected overall performance in 2002, countries in the region continued to strengthen macroeconomic fundamentals and intensify their focus on reducing poverty. The number of African countries preparing interim or final Poverty Reduction Strategies increased significantly, with nine countries finalizing them in 2002, up from four in 2001.

*Second-generation reforms firmly in place for top performers.* The Economic Policy Stance Index now pays particular attention to the efforts of countries to deepen their second-generation reforms. In the top-ranked countries—Botswana, South Africa, Mauritius, Namibia, and Tunisia, in that order—market liberalization is more advanced, and policy reversals are minimal. Institutions of policy analysis and coordination are better. Efforts to promote women’s access to education and health and gender equality in employment are highly rated. Propoor policies and targeting are effective. The legal system is effective at enforcing contracts. Laws and regulations are more predictable and transparent—and applied more uniformly. The quality of the civil service is better. And the access to and reliability of telecommunications, transport, and electricity are greater. Moreover, poverty rates are relatively low in the top performers, and fixed and mobile telephone networks, which are closely correlated with road networks, are more extensive in all these countries by a considerable margin.

“African countries continued to strengthen macroeconomic fundamentals and intensify their focus on reducing poverty”

“Growth in the region is expected to rebound moderately in 2003, to 4.2%”

*Important strides towards implementing the African Peer Review Mechanism.* The New Partnership for Africa's Development (NEPAD) made important strides in operationalizing the African Peer Review Mechanism (APRM) in 2002, critical for African prospects because it represents a bold approach for building capable states with good governance for sustainable development. Through peer pressure and peer learning, the APRM can act as a commitment mechanism to help monitor and assess the progress of African countries in implementing the NEPAD.

*Medium-term outlook mixed.* The outlook for 2003 is mixed, with heightened uncertainty about the robustness of the world economic expansion tempering any budding enthusiasm. In addition to deteriorating business sentiment in industrial economies, rising oil prices and financial sector turbulence are amplifying the risk of a return to a global slowdown. This is likely to be further exacerbated by the impact of the U.S.-led war against Iraq on the global economy (box 1). All in all, growth in the region is expected to rebound moderately in 2003—to 4.2%.

## Distilling lessons from the seven countries

The countries profiled in this year's Report reveal the range of African policy challenges. Summarized here are four key challenges in accelerating the pace of development:

- Escaping poverty—going beyond averages.
- Achieving fiscal sustainability—exiting aid dependence.
- Energizing African bureaucracies—enhancing the capacity to deliver.
- Moving to mutual accountability and coherence—taking the best route to development effectiveness.

The purpose is to highlight best and worst practices, draw lessons from the experiences of the seven countries, and provide overall policy guidance to African countries. The

### Box 1

#### *Economic impact of the Iraq war—small*

The impact of the Iraq war on Africa's economies depends on several factors: how the conflict affects the U.S. and global economy, how it influences trade and financial flows to the continent, and whether a country is a net oil importer.

Overall, the short war will have little net impact on African economies. The temporary increase in oil and gold prices will benefit the large exporters of oil and gold—Nigeria, Algeria, Angola, and South Africa—countries that account for much of Africa's GDP. Landlocked and net oil-importing countries will face short spikes in inflation and balance of payments disequilibria. The way these countries manage this external shock will determine the net effect on their economies.

countries profiled this year are Egypt, Gabon, Ghana, Mauritius, Mozambique, Rwanda, and Uganda.

## Escaping poverty—going beyond averages

The remarkable consensus and commitment for poverty reduction from governments around the world led to the Millennium Development Goals, to reduce the proportion of people in poverty by 50% by 2015 and to reduce other forms of human deprivation.

Even if the absolute poverty goal is achieved—and prospects for doing this are good for several African countries—deep pockets of poverty will remain within countries.<sup>1</sup> People chronically poor suffer poverty for many years, often for a lifetime, and are likely to transfer their poverty to their children. These are the people who benefit least from economic reforms. They experience social exclusion, because of gender, ethnicity, disability, caste, or social position. They often live in remote areas under harsh agroclimatic conditions.

Recent evidence suggests a strong relationship between poverty and agroclimatic conditions in various African countries (ECA 2002). Large differences in living standards between regions in the same country are correlated with unequal distributions of natural assets, differences in agroclimatic conditions, or differences in geographic conditions, such as remoteness from markets and transport routes (Bigman and Fofack 2000). This is intuitive. Households in remote areas, living on fragile lands, would be expected to have fewer opportunities and face greater risks and vulnerability than households in better-endowed areas. It is also consistent with the fact that poverty is more severe in rural Africa than in urban.

Several country profiles underscore this important point—the need to focus on spatial and temporal dimensions of poverty.<sup>2</sup> Uganda’s solid economic growth—averaging 6% a year over the past decade—has been accompanied by substantial poverty reduction, but there remain vast regional disparities in the incidence of poverty, with a clear spatial pattern. The more affluent central crescent area around Lake Victoria has made great strides in economic development, while the drier, more disadvantaged northern part of the country has fallen even farther behind. Uganda’s case is of concern because the spatial divide in poverty has been accentuated by almost two decades of civil conflict.

The spatial dimensions of poverty are also evident in Egypt, Ghana, and Mozambique. In Egypt—one of Africa’s emerging modern economies—the absolute level of poverty has declined, but in upper Egypt it increased between 1996 and 2000. In Ghana, national statistics show a decline in poverty from 52% to 40% over the past decade—lifting 2 million people out of poverty. But those statistics mask an increase in poverty in 3 of 10 regions—central, northern, and upper east. In Mozambique—one of the

“*Deep pockets of poverty remain within countries: governments should focus on spatial and temporal dimensions of poverty*”

fastest growing economies in Africa—poverty remains stubbornly high at 62% of the population, but it is clearly worse in the north.

The countries covered in this report suggest several ways of tackling spatial-temporal poverty. This overview highlights three particularly innovative strategies: poverty-sensitive distribution formulas for fiscal transfers, public expenditure tracking systems, and private provision of social services.

“Uganda has had impressive results with its Public Expenditure Tracking System”

### **Government spending should be poverty sensitive**

Uganda has found that government expenditures (through various fiscal transfer mechanisms) do not adequately redress regional inequalities. The current transfer payment formula allocates 85% of transfers according to the size of the district population and 15% according to the geographical location, with no consideration to poverty.

The regional distribution of transfers to local governments indicates that the western region has received the largest share (27%), followed closely by the eastern (26%), the central (25%), and the northern (22%), where poverty is highest. But if the transfer payment formula considered poverty across districts, in addition to population and size of the districts, more transfers would go to the northern districts. Such a poverty-sensitive distribution would allocate 29% to the northern region, 26% to the western, 23% to the central, and 22% to the eastern.

### **Public expenditure tracking systems**

Addressing spatial poverty also depends on how resources are translated into basic services for the poor—in such areas as health, education, water and sanitation, and energy. Public spending on these services is often biased against the poor and against rural dwellers. Ghana shows significant inequality in the distribution of educational facilities among the 10 regions and between rural and urban areas. Literacy and enrolment rates are lower in the poorer northern regions, with poor school conditions, low quality, irrelevant curriculums, and a lack of teachers. Accentuating the problems: the higher cost of schooling, with poor parents having to bear any additional costs.

Even when public spending is reallocated towards the poor, the delivery of services too often fails the poor. This may be due to corruption, imperfect monitoring of local government expenditures, and weak capacity of local governments. Rwanda and Uganda have tried to improve services by involving poor people in services through the Poverty Reduction Strategy process and by improving local expenditure monitoring systems. Uganda has had impressive results with its Public Expenditure Tracking System, introduced in 1996. The flow of intended capitation grants reaching schools shot up from 13% (on average) in 1991–95 to about 80–90% in 1999–2000.

### **Private participation in service delivery**

Most public delivery systems are highly centralized, with almost all human development programmes designed and controlled by central authorities. Given the weak

national institutions, this centralization reduces the effectiveness of human development efforts. These overly centralized systems focus on inputs rather than outcomes, are associated with low transparency and accountability, and ultimately produce inferior service delivery (Jimenez 1995; World Bank 2000).

To improve service delivery, governments are relying more on private provision and financing, as for health and education in Egypt and Ghana. Private participation in the provision of health services in Ghana is quite intensive, with about 42% of health facilities owned by the private sector. But private facilities are concentrated in the urban areas. Only mission hospitals are predominant in the poor regions. The best way to improve private participation in poor rural regions? Encouraging community-based, NGO-run health and education facilities.

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*Aid in large quantities is a double-edged sword—initially helping but eventually weakening a country’s economic performance*  
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## Achieving fiscal sustainability—exiting aid dependence

Many countries profiled in this report depend on foreign aid to fund large amounts of government spending, consumption, and investment. For instance, aid accounts for more than 50% of Uganda’s budget, 60% of Rwanda’s, and 70% of Mozambique’s. Yet there is mounting evidence that aid in large quantities is a double-edged sword—initially helping but eventually weakening a country’s economic performance (Lancaster and Wangwe 2001). Recent research shows that foreign aid crowds out private investment—a damning indictment, because the early rationale for foreign aid (the two-gap model) was to narrow the gap between savings and investment in poor countries (Clemens 2002).<sup>3</sup> Private investment is the most robust variable in explaining cross-country growth. And if foreign aid crowds out private investment, the prospects for greater prosperity in aid-dependent countries are slim.

Nowhere is this more evident than in Ghana, which has undertaken significant reforms over the past 20 years but has little to show in tangible benefits for the majority of its people. The high aid dependence reflected in poor fiscal sustainability<sup>4</sup> has hurt the Ghanaian economy, with fiscal woes providing an important explanation for the lacklustre economic performance. A chronically weak fiscal position resulting in huge budget deficits and associated spikes in inflation—often associated with political economy issues—heightened uncertainty over the credibility of government policies. This increased the risk premium associated with investing in Ghana, leading domestic and foreign investors to adopt a wait-and-see attitude.

The huge fiscal deficits led to explosions in domestic debt. Financing the domestic debt has crowded out credit to the private sector, further constraining financing options for firms. Financing deficits by issuing high-yielding treasury bills inverted the yield curve for government securities, giving higher rewards to investors in short-dated securities than in long-dated securities. With many investors preferring short-term government

treasury bills, private firms have had trouble raising long-term capital. This has also shifted resources from the securities market to the government bill market, leaving the securities market thin and illiquid.

**“Fiscal sustainability requires going beyond the country’s external debt to the sustainability of aggregate public sector debt”**

Egypt’s fiscal deficit has also been on the rise. Like Ghana, it has seen rapidly rising domestic debt, with interest payments on this debt, along with the wage bill, taking up around half of public expenditure. Because these areas of expenditure cannot be cut back easily, they seriously reduce the authorities’ room for maneuver in fiscal policy. With sluggish economic growth and high domestic interest rates the ratio of domestic debt to GDP is likely to continue to rise, posing difficulties in macroeconomic management.

### **Heavily Indebted Poor Country status confers benefits and risks**

Foreign aid provided through concessional loans to many African countries over the past several decades has created large debt overhangs and significant debt servicing obligations. The poor fiscal state of several African countries and their high levels of external debt led the World Bank and the International Monetary Fund (IMF) to develop the Heavily Indebted Poor Countries (HIPC) Initiative. The programme contemplates forgiving a fraction of these countries’ bilateral and multilateral debt. The funds freed by debt relief are to be devoted to effective social programmes, which in the eyes of the multilateral institutions will reduce poverty. In addition, the country is expected to impel broad economic reforms to strengthen the productive sector and increase the potential for growth.

An important principle guiding the programme is that in the post-HIPC era the country will achieve “external sector sustainability”, and thus not require new rounds of debt forgiveness.<sup>5</sup> The Bank and the IMF (2001, p. 4) have stated this principle in the following way:

[B]y bringing the net present value (NPV) of external debt down to about 150 percent of a country’s exports or 250 percent of a country’s revenues at the decision point, [the programme] aims to eliminate this critical barrier to longer term debt sustainability for these countries.

An important question tackled here is what type of fiscal policy will be consistent with maintaining debt sustainability in the post-HIPC era. As the excerpt above suggests, the multilaterals have focused on policies required to stabilize the ratio of external debt to exports. The Ghana profile shows that a comprehensive answer to the fiscal sustainability question requires going beyond the country’s external debt to the sustainability of aggregate public sector debt, including both foreign and domestic debt. Ghana has accumulated a significant stock of domestic debt, purchased by the local banking sector, pension funds, and individuals. Indeed, by ignoring domestic debt, sustainability analyses may underestimate the fiscal effort that poor countries will have to make in the post-HIPC era.

Such large fiscal adjustments could have important political economy consequences (Edwards 2002). First, the adjustments may reduce the funds available to implement the antipoverty programmes. And second, very large reductions in primary expenditures may lead to political instability and backtracking on reform.

### **Slipping back into the debt trap**

Unless HIPC countries, such as Ghana, Uganda, and Rwanda, receive substantial concessional aid in the future, their public sector debt is likely to become unsustainable once again. Uganda, the first country to graduate from the enhanced HIPC programme in 2000, is in a difficult situation. The debt and debt service indicators in net present value terms show that its debt sustainability has not improved since it received HIPC debt relief. The net present value of debt to exports ratio increased from 170% in 2001 to 200% in 2002 and is projected by the IMF to increase to 208% in 2003, well above the threshold of 150% under the enhanced HIPC framework. Similarly the net present value of the debt-GDP ratio is projected to increase from 20% in 2001 to 22% in 2003.

The reason for sliding back into the debt trap: without large volumes of concessional assistance, these countries would be forced to undertake major fiscal adjustments to achieve sustainability (Edwards 2002). Adjustments of this magnitude usually crowd out social expenditures, including poverty alleviation programmes, and tend to create political economy difficulties.

### **The optimal size of a fiscal deficit**

The fiscal sustainability question in Rwanda is slightly different. Tensions are emerging between the requirements for macroeconomic stability and for poverty reduction and post conflict construction. The fiscal deficit, on the rise in recent years, is projected to remain high over the medium term. The reason is the increase in public expenditures to address poverty reduction goals set out in the Poverty Reduction Strategy and the need for post-conflict reconstruction—for demobilization and for establishing peoples courts, the genocide survivors fund, and governance commissions. Some development partners recommend that a country like Rwanda, with large fiscal deficits financed by grants and international borrowing, should reduce the deficit in the medium term rather than mobilize additional resources.

Further contradictions have emerged with Rwanda's HIPC status. The use of exports in the HIPC debt ratios implies that absolute levels of debt per capita will be particularly low for a closed economy, such as Rwanda. This has increased the debt relief but it will also reduce the possibilities for new borrowing. So, over the medium term, rising spending needs for poverty reduction and post-conflict reconstruction mean that Rwanda is unlikely to adhere to low debt to GDP ratios as required by HIPC. The reason? Doing so would reduce the government's ability to contract new loans. It is clear that adherence to HIPC debt ratios has hidden costs that may easily outweigh the benefits.

**“** Adherence to HIPC debt ratios has hidden costs that may easily outweigh the benefits **”**

“**Macroeconomic sustainability cannot be divorced from political sustainability**”

Several lessons from Rwanda question the relevance of current modalities in the HIPC programme. First, as illustrated in the profile, Rwanda's underlying debt sustainability indicators appear to be flawed. Much of the sustainability analysis by the World Bank and IMF is based on rather optimistic assumptions for future economic performance, the external environment, and projected financing needs.

Second, macroeconomic sustainability cannot be divorced from political sustainability. The legacy of violence must be considered, especially with past civil violence a strong predictor of future violence. The needs of social and political reconciliation are therefore critical. And a macroeconomic programme that does not address these issues could be dangerous.

An alternative to the HIPC criteria would be to link debt relief to a proportion of revenues needed for essential spending, possibly with different limits set for different groups of countries. One proposal is to add a criterion for countries emerging from conflict—putting an upper limit to the fiscal revenues used for debt servicing. HIPC needs must also take greater account of external shocks and the critical role of declining terms of trade in the buildup of debt, an issue so far neglected (Birdsall and Williamson 2002; Nissanke and Farrarini 2002).

### **Even strong performers are concerned about fiscal imbalances**

The Mauritius profile highlights another angle in fiscal sustainability. With stellar macroeconomic performance, the economy grew 5–6% a year over the last 20 years. Inflation remained in single digits. And the fiscal deficit averaged about 4% a year between 1985 and 1999. But in 2001 it jumped to about 6.7% of GDP, and for 2002 it is expected to remain around 6%–6.5%, narrowing to previous levels from then onward.

These higher deficits are the result of a massive investment programme by the government to prepare the Mauritius workforce and infrastructure for economic diversification—away from the traditional sectors of sugar, textiles, and apparels, now losing their potential as engines of growth, and towards a knowledge-based economy. There is concern among some development partners that higher deficits will threaten fiscal sustainability. The analysis here shows that this may not be the case. The main issue is to resolve the tension between higher deficits in the short term and investment that may yield higher returns in the medium to long terms.

### **A smooth exit requires a strong private sector**

Exiting aid dependence and improving the fiscal position of African countries will require governments to implement policies and use resources to promote growth that will expand public revenues and obviate the need for future aid.

A strong private sector is critical to achieving this goal. Only through a strong private sector that contributes to the state's coffers will the abysmally poor fiscal position of

African countries be improved. The point is not that countries should not improve tax administration and reduce leakages due to inefficient spending—it is that they should also take actions to broaden the tax base, so that they can get more tax revenues for the same marginal tax rate.<sup>6</sup>

Managing the transition to less development assistance and more private capital flows will require a combination of measures—to increase domestic resource mobilization, provide greater debt relief, reform the current aid regime, improve market access, and enhance the policy environment. This will include improving the business climate—strengthening corporate governance, commercial justice systems, and the regulatory environment. It will also include improving pricing and access in electricity, transportation, and telecommunications, igniting the private sector’s supply response.

## Energizing African bureaucracies—with more capacity to deliver

The public service bureaucracies will play a critical role in accelerating the pace of development (figure 1). Yet they play a contradictory role, at once part of the problem and part of the cure (Kayiizi-Mugerwa 2003). Economic reforms are matters of public policy. But policies are no more effective than the bureaucracies trying to implement them.

Egypt and Ghana demonstrate the predicament. Despite 20 years of institutional reforms in the public sector, there is little to show for it. These reforms, like those in many African countries, focused on quantitative issues—wage and hiring freezes, downsizings, and retrenchments. They paid little attention to more subtle and challenging issues of bureaucratic quality. In Egypt, state capacity needs badly to be reinvigorated to improve export competitiveness and propel the economy to a higher stage of development. But the reform of institutions faces political and administrative constraints. In Ghana the situation has deteriorated so much that the current government now faces a crisis in the public service.

Two statements from the Ghana Poverty Reduction Strategy reinforce this assessment (Ghana 2003, p. 109):

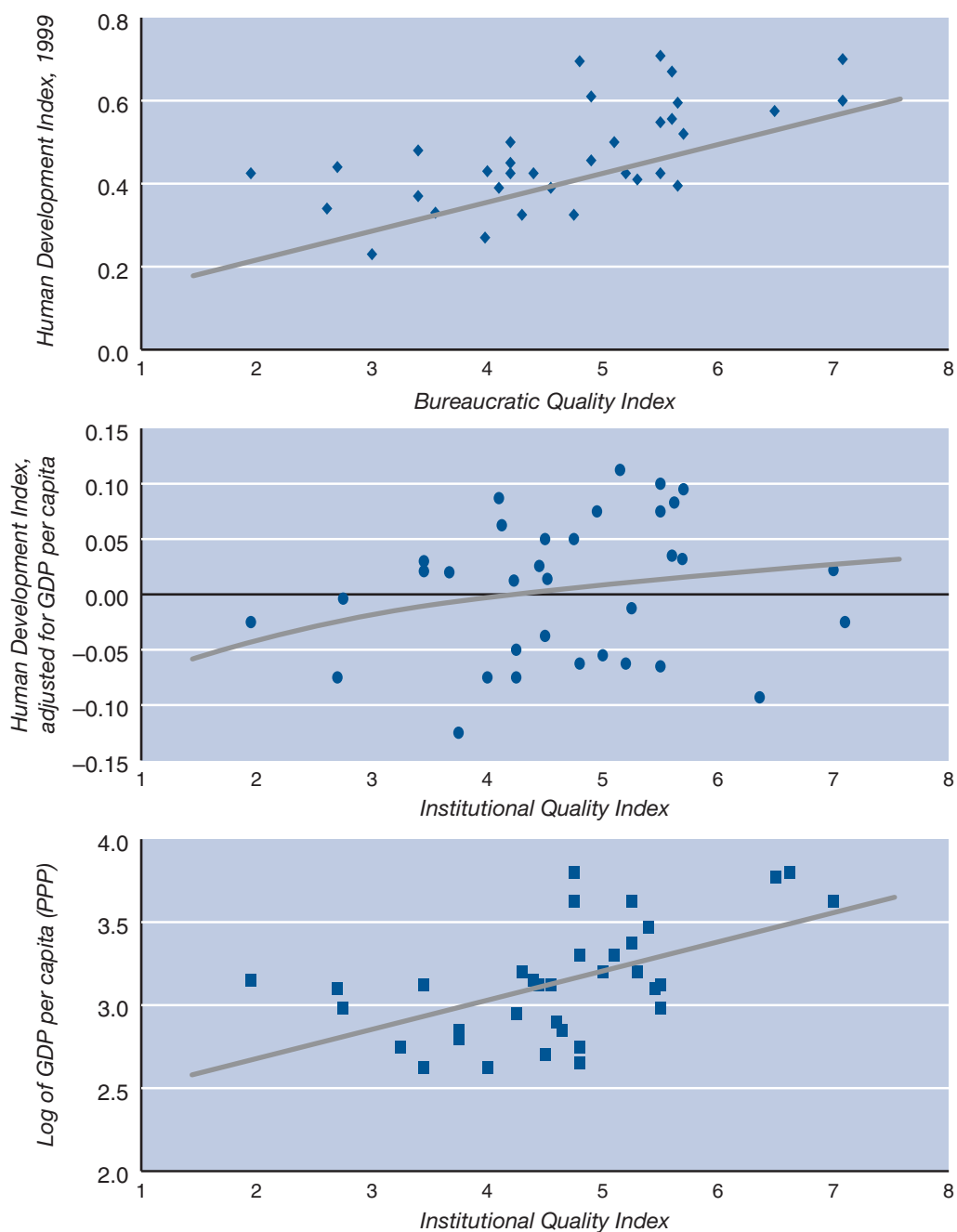
It would appear that the totality of the public sector reform programme might be beyond the capacity of the available human and financial resources to plan and implement.

However the reform process cannot proceed effectively without sustained and palpable political commitment, the enforcement of agreed proposals for reform from a political and official level and provision of adequate resources.

The key reform in Ghana—the Public Financial Management Reform Programme, initiated in 1995—introduced an integrated payroll and personnel database, a medium-term

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**Figure 1**  
*Bureaucratic quality is positively related to development*



**Note:** The Bureaucratic Quality Index combines factor loadings of government stability, democratic accountability, law and order, and corruption. The sample consists of 39 African countries.

**Source:** Economic Commission for Africa and IMF 2002.

expenditure framework, and a budget and public expenditure management system. But at the end of 2002 the government was still grappling with the same issues as in 1995.

Several factors are responsible. But compensation and ineffectual management of the public service—including the absence of an overall human resource development, use, and retention strategy—are the prime causes.

### **Participatory policymaking can be highly effective**

In stark contrast, the policy formulation process in Mauritius “contains a very strong dose of consultation, dialogue, consensus building, and democratic principles, ensuring that all concerned stakeholders are actively involved” (Bonaglia and Fukusaku 2002, pp. 171–73). Public-private partnership is pervasive in Mauritian policymaking, and nongovernmental organizations have always been an important part of Mauritian society. As a direct result, public policies have supported high rates of private investment.

The Joint Economic Council is the private sector’s apex organization. When a private sector position needs to be voiced, the council expresses it after consulting with members. At least twice a year the government holds meetings with the council, chaired by the prime minister and attended by senior ministers. Structured consultations are also held with private sector organizations, trade unions, and the minister of finance to prepare the national budget. Between budget preparations sessions, there is constant dialogue between the private sector and government through meetings on specific policy matters. Business, labour unions, and government are involved in tripartite wage negotiations.

Private sector and union representatives sit on the National Negotiating Committee on Post-Lomé discussions, the World Trade Organization standing coordination committee, and the Regional Cooperation Council. They also take part regularly in World Trade Organization ministerial conferences.

The participatory policymaking in Mauritius enables all stakeholders to shape the national economic strategy, with private needs reflected in government policy, in line with the country’s development objectives.

## **Moving to mutual accountability and coherence—the best route to development effectiveness**

There is much dissatisfaction with the state of development partnerships in Africa (ECA 2001). It stems from a vicious circle of high expectations, grand promises, and only partial accomplishment of goals. There is also the frustration of Africans (that expected benefits were not fully realized) and of development partners (that imple-

“*Public policies have supported high rates of private investment in Mauritius*”

“ *There is much dissatisfaction with the state of development partnerships in Africa: it stems from a vicious circle of high expectations, grand promises, and only partial accomplishment of goals* ”

mentation was not as expected and the funds provided were not used effectively). The African side blames unrealistic project design, excessive conditions (some of which were just plain wrong), and slow and unpredictable access to promised funds. The donors blame corruption, inadequate political will, and poor implementation by the Africans. There is considerable evidence to support both points of view (Lancaster and Wangwe 2001).

If the pace of Africa's development is to be accelerated it is imperative that the relationship between Africa and its partners be within the context of interdependence, cooperation, and mutual accountability (ECA and OECD 2002). That is the emerging consensus. Predictability and accountability should be mutual. National leaders should carry out their programmes and inform supporting partners of any changes. Partners should provide the promised resources in a timely manner or consult on the proposed changes. Each should be accountable for fulfilling commitments. Agreements should be clear, stating events and timing, with all to be monitored.

This consensus is reflected in the pledge by world leaders at the UN Conference on Financing for Development in Monterrey:

A substantial increase in ODA and other resources will be required if developing countries are to achieve the internationally agreed development goals and objectives, including those contained in the Millennium Declaration. To build support for ODA, we will cooperate to further improve policies and development strategies, both nationally and internationally, to enhance aid effectiveness (para 22).

The international community is also committed to intensifying efforts to lower external debt burdens, improve market access, and reduce constraints that prevent poor countries from fully realizing the benefits of globalization. In turn, developing countries acknowledged that they must take responsibility for good governance and sound policies, as African leaders are doing under the New Partnership for Africa's Development (NEPAD). These leaders have committed to implementing sound economic policies, tackling corruption, putting in place good governance, investing in people, and establishing an investment climate to attract private capital. Mutual accountability requires that pledges by both sides be monitored. Box 2 describes an indicative "first set" of performance indicators that could be used to jointly monitor progress by African countries and external development partners on specific commitments and related reform efforts.

### **Increase the predictability of aid flows**

Several country profiles underscore the importance of mutual accountability for development effectiveness. For instance, an important feature of mutual accountability is that partnership arrangements should be clear and predictable. It is accepted that major changes in a recipient country may legitimately require a reevaluation of partnership agreements (for instance, if serious conflict breaks out in the country that had been

## Box 2

### Possible indicators for joint reviews of development effectiveness

#### For external development partners

##### *Medium-term aid flows and support within local medium-term budgeting and planning frameworks*

- Proportion of donors working within medium-term development frameworks derived from national Poverty Reduction Strategies.
- Proportion of aid resources included or reported within medium-term expenditure frameworks.

##### *Donor practices*

- Progress in reducing the number of donor missions and increasing the number of joint missions.
- Progress in sharing country analytical work programmes and products of donor agencies, and more systematic preparation of such products in ways that strengthen partner capacity.
- Extent to which donors are working jointly (joint sector support, joint budget support, joint evaluations, delegated cooperation).
- Extent to which donors use common reporting formats.

##### *Capacity building*

- Support for national capacity development strategies.
- Donor policies and practices on use and remuneration of local professionals in donor field offices and in public service (use of project implementation units and salary and other incentives in relation to local salary structures).

#### For African countries

##### *Peace, security, and political governance*

- Free and fair elections of all branches of the state, independence of the judiciary, and existence of a free press.
- Clear separation of powers of the judiciary, legislative, and executive branches.
- Freedom of association of political parties, trade unions, peasant organizations, and other private organizations.
- Absence of involvement in nonsanctioned military conflict in other sovereign states.

##### *Economic and corporate governance*

- Comprehensive and transparent public accounts covering both expenditures and revenues (including royalties).
- Existence of an independent public accounts committee in the legislature with an oversight function. Implementation of recommendations of the committee and independent government auditors.
- Legislation requiring parliamentary approval of external debt.
- An independent commercial justice system.
- Three-year moving average for inflation and the average weighted tariff rate.
- Barriers to capital imports not excessive.

*(continued on next page)*

## **Box 2** (continued)

### *Possible indicators for joint reviews of development effectiveness*

- Regulation of business not overly burdensome.
- Independence of the central bank.
- A nationally owned development plan (or poverty reduction strategy) produced in a participatory fashion and covering trade and private sector development.
- A medium-term expenditure framework (or other medium-term budgetary and planning mechanism) and prioritized sector programmes to ensure effective use of resources.

#### *Human development*

- Childhood immunization coverage (DTP3) of at least 50 percent.
- Nonsalary recurrent spending on basic education per school-age child of at least 10 percent of government revenue.
- An HIV/AIDS treatment and mitigation policy.
- Gender equity in access to primary education.

#### *Capacity building*

- Existence of an operational government strategy for national capacity building, including civil service reform, encompassing salary top-ups.

peaceful and secure). This was the case in Uganda, where an unplanned increase in defense spending of about 0.5% of GDP in 2002/03 budget led to a reevaluation of multilateral and bilateral relationships. Defense expenditures are projected to be around 5.6% of GDP in 2002/03 compared with 4.6% in the previous three years. The rise in the defense budget, especially the spending over budget, has raised concerns among several donors, with the government arguing that the increase in spending is necessary to decisively address the security situation in the north.

However, the foreign partner too frequently makes unilateral changes in agreements without consultation. The result: serious disruption of important national programmes and uncertainty about how to plan for the future. In Ghana development assistance that was expected in January 1, 2002 was belatedly received on December 31, 2002. The budget deficit rose to 6.9% of GDP in 2002 (from 4.4% the year before) partly because only 18% of promised grants had been received by the third quarter.

Mutual accountability requires clear understanding by both parties about the timing of release of promised aid funds, and donors should be held accountable for delivering on their promises. Consultation should be the rule if changes are thought to be needed.

To address the unpredictability of aid flows, donors need to programme their aid over a multiyear timeframe consistent with the financial planning horizon of recipient governments.

For this to happen:

- Medium-term commitments should be aligned with medium-term expenditure frameworks, so that the country can plan Poverty Reduction Strategy activities well in advance.
- Yearly disbursements should be aligned with the fiscal budget so that countries can deliver services planned in the medium-term expenditure framework.
- Development partners should provide recipient governments with full information on aid flows, on a regular and a timely basis.
- Development partners should let the recipient government know in advance what information should be included in the annual reviews, streamlining the requests and reducing the number of additional ad hoc requests for information.

Consider Rwanda, where the British government in 1998 entered a 10-year relationship to improve the predictability of resource flows and set up an independent body to review donor practices. The United Kingdom has also led the way in shifting funding towards budget support, with a new programme of budget support of £76 million for 2000–03 agreed in 2000.

### **Reduce donor “frenzy”**

Partnership based on mutual accountability should reduce the high transaction costs for recipient countries. Many African countries receive assistance from several partners in the same economic sectors, with each partner insisting on detailed conditions for its assistance. The conditions exacted by the partners often are not consistent. And the timeframe for the partner agreements tends to be short, creating uncertainty for ongoing programmes and requiring the time of national leaders to negotiate follow-on agreements.

Reducing the high transactions cost requires improving donor coordination and harmonizing development assistance programmes. For this the partners need to align their policies and programmes with the Poverty Reduction Strategy or other nationally owned development plans.

The Uganda profile shows that donors are aligning their programmes around the PRS. But this is not happening across a wide range of countries. For example, in Mozambique, where some progress has been made in this regard, the government is concerned about the burden presented by project aid that bypasses national systems and priorities. Aid there is fragmenting ministries, weakening national and ministerial identity, and undermining authority.

Rwanda has new Guidelines for Productive Aid Coordination, with the Poverty Reduction Strategy now providing the framework for aid coordination. It is also considering a lead agency arrangement, with the largest donor to a sector taking the lead in that sector. A lot more needs to be done in this area (box 3).

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*Many African countries receive assistance from several partners in the same economic sectors, with each partner insisting on detailed conditions for their assistance*  
**”**

Reducing transaction costs may require that development partners move away from project aid towards budget support, which for countries with transparent budget procedures and sound public expenditure management systems is another critical feature of mutual accountability, as in Ghana.

### **Box 3**

#### ***Despite the rhetoric, donors not yet fully behind Poverty Reduction Strategies***

The Strategic Partnership with Africa carried out pilot action learning missions to three African countries in 2002. The purpose was to investigate specific measures for aligning donor practices with national Poverty Reduction Strategy (PRS) processes and cycles. The missions were to explore, with governments and in-country donors, the possibilities for developing a coordinated government-led, annual PRS cycle, with aid financing, procedures, and practices lined up behind a national review process and budget cycle. The missions also sought to elicit an agenda of the changes needed for donor policies, procedures, and practices to line up behind a nationally led PRS cycle.

##### *Findings*

- The number of donor conditions has shown no tendency to decrease.
- The process for agreeing to specific policy actions required by donors remains nontransparent, and is not based on the country's own policymaking process.
- Reporting requirements have not been aligned, either with each other or with the countries' own information systems.

##### *Actions by African governments*

- Translate medium-term indicators, targets, and policy commitments into annual goals against which progress can be measured.
- Clarify the link between the PRS annual review and national budget and planning cycles.
- Clarify the links between PRSs and sector programs.
- Ensure consistency between the PRS and medium-term budget allocations.

##### *Actions by donors*

- Agree to use the annual PRS review to assess and review country performance and conditions.
- Align disbursements with the government's budget cycle.
- Notify governments, in advance, of the specific information they would like to see included in the annual reviews, and streamline their requests.
- Avoid making additional ad hoc requests for information.
- Support governments through capacity building and appropriate technical assistance.
- Align conditionality with the PRS, and simplify it where possible. A common set of conditions would include all the requirements of all donors providing budget support, but each donor would link its support to its own subset of conditions and render its own judgement about whether these conditions have been met.

**Source:** *Strategic Partnership for Africa 2002.*

The government of Ghana has a multidonor budgetary programme to support the Poverty Reduction Strategy, requiring donors to provide resources through the government budget and in line with the budget cycles. Participating development partners follow common rules for disbursement and commit themselves to firm financing over the coming year, with indicative commitments for the following two years. Funds are not earmarked for specific activities. Instead, the government and the development partners participating in the programme have agreed to focus on some key reform areas viewed as critical for the successful and efficient implementation of the strategy: public finance accountability reforms, budget processes, decentralization, civil service reform, and governance. For each area of priority actions, a policy matrix will provide benchmarks for monitoring progress.

The process is facilitated through regular quarterly mini-consultative group meetings. Regular monitoring reports from the government will be in a standard format, including quarterly reports on macroeconomic indicators, the policy matrix, expenditures against the budget and releases, and implementation of the strategy. In turn, development partners are to provide quarterly reports on disbursements and projections of disbursements for the next two quarters.

### **Making development policies coherent**

The success of development policy depends on the effects of other policies, which intentionally or unintentionally may impair development cooperation. The coherence of development policies has to do with ensuring that all policies affecting African development prospects are synergistic—and do not conflict or nullify each other. A lack of coherence has been shown to lead to ineffectiveness (failure to achieve objectives), inefficiency (waste of resources), and loss of policy credibility.

Chapter 1 of the report documents several examples of incoherence in the development policies of Africa's major partners. For example, the EU advocates African countries' integration into the world economy, but its trade policy has numerous protectionist elements, especially in agriculture. An open trade policy and dismantling of the Common Agricultural Policy would complement EU development efforts rather than frustrate them.

To improve food security in West Africa, German development cooperation has promoted beef production in that region, but the success of these projects has been threatened by subsidized EU beef exports to the same countries. The 2002 U.S. Farm Bill, scaling up subsidies, is another example of a policy that conflicts with the government's pledge to reduce poverty in Africa.

In general, Africa's international partners have not implemented their commitments, particularly for enhancing market access and eliminating trade-distorting agricultural subsidies. Abolishing OECD agricultural subsidies would provide developing countries with three times their current ODA receipts. The elimination of all tariff and non-tariff

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*In Uganda donors are aligning their programmes around the Poverty Reduction Strategy. But this is not happening across a wide range of countries*  
**”**

barriers could result in static gains for developing countries of around \$182 billion in services, \$162 billion in manufactured goods, and \$32 billion in agriculture.

Tariff escalation in the international trade regime makes it difficult for African countries to diversify their economies towards high-value-added processed goods. Tariff peaks—rates above 15%—are often concentrated in products of export interest to developing countries. Two sectors that matter most for developing country exporters are textiles and agriculture. Tariff barriers in textiles remain high, while high tariffs for agricultural commodities and the continued subsidization of agriculture in many OECD countries repel agricultural exports.

The success of the Doha Development round of multilateral trade negotiations is crucial for improving market access for Africa's exports. But given the apparent breakdown in these crucial talks, there is a strong case for OECD countries to frontload the benefits of trade liberalization for the poorest countries by providing immediate duty-free and quota-free market access.<sup>7</sup>

Because Africa depends more on external trade than do other developing regions, expanding market access for its exports is a clear priority. Of developing country GDP in 2001, 34% came from the exports of goods and services, but for Sub-Saharan Africa, the figure was 40%.

### **Mutual accountability—Africa's role**

Mutual accountability is a two-way process. Partners have to fulfill their part of the bargain, and Africans have to fulfill theirs. For Africans, the commitment to self-monitoring and to peer learning is the linchpin to accountability. (This is distinct from the accountability of having recipients report their compliance with donor requirements, including conditionality.) NEPAD is implementing an African Peer Review Mechanism (APRM) to encourage self-monitoring and peer learning (box 4). This systematic assessment tool will track progress of outcomes, identify and reinforce best practices, assess capacity gaps, and implement the required corrective actions.

Several African countries have already agreed to undergo peer reviews. What is left now is to move forward with implementing APRM and show that African countries are fulfilling their side of mutual accountability.

### **Good governance is the key to mutual accountability**

Several country profiles demonstrate the progress African countries have made in improving governance. In Mozambique the current president has announced that he will step down in 2004 and refrain from anointing a successor. This is a potent signal of the political leadership's commitment to democracy and the rule of law.

Rwanda is also taking positive steps towards deepening democracy and good governance, announcing that multiparty presidential and parliamentary elections will be held

**“Africa's international partners have not implemented their commitments, particularly for enhancing market access and eliminating trade-distorting agricultural subsidies”**

in mid-2003. Crucial to the success of this gradual political normalization are attempts to foster social reconciliation through local tribunals, aimed at paving the way for the eventual reintegration of genocide suspects into their communities. Connected to these efforts is a bold decentralization programme to increase community participation, but serious capacity constraints are apparent in most localities.

Ghana's smooth political transition in January 2001 brings hope that the new government will create an atmosphere of transparency and participation. This has led to more open debates on major policy reforms, such as the recent increase in fuel prices, the adoption of the Heavily Indebted Poor Countries Initiative, and privatization of water.

Mauritius, with a long period of political stability, remains a sterling example of democracy. The rule of law prevails. Property rights are respected. And public sector activities have been transparent and conducive to private sector activities. The result: the transformation of a poor country with a per capita income of \$260 at the beginning of the 1960s to a middle-income country with a per capita income of \$3,800 in 2003.

#### **Box 4**

##### ***NEPAD and the African Peer Review Mechanism***

A critical plank of the New Partnership for Africa's Development (NEPAD) is the African Peer Review Mechanism (APRM). The APRM will be used to assess the performance of African countries in terms of their compliance with a number of agreed codes, standards, and commitments that underpin good governance and sustainable development. It represents a sea change in the thinking of African leaders as they seek to reverse political authoritarianism, state failure, and corruption to embrace and consolidate democracy and ensure sound and transparent economic management.

The Economic Commission for Africa has been deeply involved in developing the economic and corporate governance codes and standards for the APRM. Good economic and corporate governance can help countries attract more investment and achieve higher rates of per capita growth. A state that applies rules and policies predictably and fairly, ensures order and the rule of law, and protects property rights will generate confidence and attract more domestic and foreign investment. That, in turn, will generate trade and faster economic growth, providing the wherewithal for sustainable development.

The weakness of the institutions of economic and corporate governance, as a constraint on sustainable development in Africa, is clear and convincing, limiting the public sector in the fulfillment of its economic functions. Strong institutions are needed to maintain fiscal and monetary discipline, mobilize resources, and set priorities among the competing demands for those resources. Similarly, institutional arrangements are required for the efficient delivery of pro-poor public services. In addition, there must be institutional mechanisms to ensure accountability through the capacity to monitor and enforce rules and to regulate economic activities in the public interest. The APRM has the potential to make these desires a reality.

**“Mutual accountability is a two-way process: for Africans, the commitment to self-monitoring and to peer learning is the linchpin to accountability”**

## Notes

1. For instance, Uganda has reduced poverty by 22 percentage points over 10 years.
2. The temporal aspect of poverty refers to transitions into and out of poverty, which are often correlated with seasonal fluctuations in food availability.
3. This contradicts the now classic study that finds that where the policy environment is supportive of economic investment, an extra dollar of aid increases investment by nearly twice that amount (Dollar and Burnside 1998).
4. *Fiscal sustainability* refers to a situation in which the ratio of a country's public sector debt to GDP is stationary and consistent with overall demand—both domestic and foreign—of government securities.
5. The World Bank and the IMF (2001) recognize that there is no assurance that these countries will not face future debt problems. According to their document, achieving sustainability will require a rapid and stable rate of economic growth.
6. Higher marginal tax rates are likely to have a greater disincentive effect on trade and private investment.
7. Canada announced duty-free, quota-free access to the least developed countries at the Kananaskis G-8 Summit in June 2002. The African Growth and Opportunity Act gives African countries access to the U.S. market.

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