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An Integrated Approach to Africa's Development Constraints

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Over the last two decades, many African countries have undertaken major economic reforms, on their own or with the assistance of multilateral development institutions such as the World Bank and the IMF, to achieve economic stabilisation and improve economic performance. Embracing a market-friendly framework has been at the heart of these reforms, which included liberal trade and exchange rate policies, financial sector deregulation, privatisation, and public sector downsizing. Improved macroeconomic management in the continent coupled with improving governance in many countries have resulted in greater macroeconomic stability manifested in lower inflation rate, declining fiscal and current account deficits as well greater transparency in Africa's monetary systems and public finance. This has enhanced confidence in public policy and reduced uncertainty for private investors in many African countries.

Africa's average growth rate has been steadily increasing recently, reaching 4.3 percent in 2003 and 4.6 percent in 2004, due largely to: global expansion that led to higher demand and prices for commodities; a significant increase in official development aid, driven mainly by debt relief and emergency assistance; and improving macroeconomic stability.[2] Yet it is a long way for the continent to achieve sustainable growth

[1] The chapter is based on work done at UNECA, but the views expressed here are solely mine and do not represent UNECA.

[2] OECD/AfDB, *African Economic Outlook, 2005*, OECD and African Development Bank, Paris/Abidjan, 2005.

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rates commensurate with its development targets, namely the Millennium Development Goals (MDGs).

More importantly "economic performance in the continent remains fragile due to: unpredictable weather conditions; concentration of production and exports in the commodity market; and volatile external capital flows that are also too tiny relative to global capital flows. Meanwhile, though increasing, domestic saving and investment rates in Africa remain low by international standards and in relation to the resources needed for Africa to achieve its development goals".[3]

Kamran's Kousari's chapter clearly highlights many of the above constraints and identifies key overall economic challenges faced by Africa in terms of: (1) the fact that economic growth in Africa is highly dependent on weather conditions and exogenously-determined commodity prices, where most of African countries rely on the agricultural and extractive sectors; (2) the effects of aid conditionality on domestic policy and economic performance; (3) problems of debt overhang and debt servicing commitments that affect the ability of countries to finance development; and (4) liberal trade policies that open up the markets of African countries, while many of their trading partners in the developed world continue to protect their markets. It is worth emphasising that the chapter underscores the fact that "international actions exert a major influence not only on the external conditions facing Africa, but also on domestic conditions".

However, by focusing mainly on external constraints and policy actions, Kamran's chapter leaves out many important domestic factors that can be equally important in influencing Africa's economic performance. We argue that an integrated approach to analysing Africa's internal and external constraints provides a better understanding of these constraints that need to be simultaneously confronted. This is important because research has shown that even if all external, for example debt and aid, constraints are removed Africa will not realise sustainable development in the absence of good domestic policies. Conversely, even if feasible, good domestic policies alone are not enough for achieving desired growth rates in Africa without external support.

[3] UNECA, "Unleashing Private Sector Development in Africa", Policy Report by the United Nations Economic Commission for Africa, Addis Ababa, 2005 (forthcoming).

Africa's Financing Needs

In addition to the need to simultaneously address external and domestic constraints on Africa' development, an important question arises as to why aid conditionality and external capital flows fail to adequately respond to improving macroeconomic conditions and policies in the continent. The answer to this question seems to lie in the fact that external policy restrictions remain important as far as perceived or real policy and other risks are strong. Donors and foreign investors see many countries in Africa as lacking either capacity or commitment to good policymaking. While more domestic policy measures and reforms need to be implemented for the continent to consolidate improvements in the macroeconomic environment and prove the ability of local initiative to drive growth, improvements in the international environment are also needed for domestic policies to be successful. So, there is a two-way link and interaction between domestic and external factors and policies.

The Monterrey Consensus[4] of the International Conference on Financing for Development (FfD) illustrates how domestic and external constraints can be analysed and provides a useful framework for policies to simultaneously confront them. Whereas the Monterrey framework calls for an integrated approach to resolving internal and external constraints on development in developing countries, "the prospect of rather less than the envisaged inflows, and the likelihood of even more pervasive and intrusive conditionality" has persuaded some African policymakers to shift focus to internal policies and programmes that can be implemented with or without external support.[5] This shift has received strong support from research, which indicates, "Permanent solutions can only come from within African countries themselves, with help from outside being based upon their own resources and initiatives".[6] This implies that more attention should be given to domestic resource mobilisation, at national as regional levels.

In fact, African policymakers have long noted that despite concerted

[4] See for example, United Nations, "Report of the International Conference on Financing for Development", held in Monterrey, Mexico, 18-22 March 2002, United Nations, New York.

[5] See Kwasi Anyemedu, "Financing Africa's Development: Can Aid Dependence Be Avoided", mimeo, CODESRIA/Third World Network, 2002.

[6] See for example, Louka T. Katseli, "Financing Africa's Development", Summary Recommendations of the Fifth International Forum on African Perspectives 2005: What is New for Africa?, organised by OECD, Bercy, June.

Table 1 The Resource Gap and External Financing for Africa

	1993	1998	2002
Gross domestic investment (% GDP)	18.7	21.6	21.5
Gross domestic savings (% GDP)	16.6	16.8	21.0
Budget deficit (% GDP)	-4.4	-3.0	-2.9
Official development assistance[1]	21.2	17.84	22.16
Debt disbursement[1]	21.0	13.49	16.01
Net transfers on debt[1]	-4.19	-13.46	-10.08
Net Foreign direct investment	2.49	9.87	13.27

Note:
[1] Nominal $ billion
Source: World Bank Africa Database, 2004.

efforts by African countries and their development partners to enhance official assistance, promote debt relief, increase and mainstream trade, and accelerate economic and financial reforms to boost domestic investment and external resource mobilisation, most countries are unable to meet the MDGs, chiefly because of the overriding financing constraint. It is also generally recognised that partial reforms and policy measures are unlikely to be effective in resolving Africa's financing needs.

For example, economic and financial reforms have contributed to a notable recovery in many African countries in terms of macroeconomic stability and growth since the mid 1990s but both internal and external resource flows remain far below the levels required for these countries to finance their development needs (Table 1). Despite notable increases in domestic saving rates and recovery in official and private capital flows, including foreign direct investment, Africa has not yet been able to boost the domestic investment rate. With unsustainable debt levels in many countries, substantial debt relief is needed for Africa to capitalise on domestic saving and foreign capital flows to finance infrastructure and other investment to meet its development targets.

Africa needs a holistic approach to simultaneously address domestic and external development constraints.

Needed Actions Within a Holistic Framework

The above challenges can best be addressed within the framework of the Monterrey Consensus, which notes that in the increasingly globalising interdependent world economy, a comprehensive approach[7] to the interconnected national, international and systemic challenges of development financing in all parts of the globe is essential. In this light, countries or regions might be able to develop an integrated framework to take actions to enhance develop financing and thus confront a key development constraint from both internal and external angles. Leading actions within this holistic framework are:

Mobilising domestic resources for development. This requires good governance, appropriate policy and regulatory frameworks, control of corruption, capacity building, and an effective, efficient, transparent and accountable system for mobilising and allocating public as well as private resources. Domestic resource mobilisation and private domestic capital formation is the largest source of new investment in developing countries. On average, it is five times the level of foreign investment. However, effective resource mobilisation and use in Africa requires further reforms to widen and deepen the domestic financial sector, adopt prudent fiscal and monetary policies, and improve legal systems and economic as well as corporate governance. To strengthen capacity for domestic resource mobilisation, there is a need for, among other things, the development of a continental domestic resource mobilisation strategy, and the creation of an African Monetary Fund, a continental investment bank, and a continental capital market.[8] Africa should also harmonise laws and regulations across countries, develop debt markets, adopt a continental banking charter and create appropriate institutional structures to attract more remittances and direct them to better uses.

Mobilising international resources for development (FDI and other private flows). To attract increased private productive capital flows, countries need to ensure a transparent, stable and predictable investment climate, with proper contract enforcement and respect for property rights, and sound macroeconomic policies and institutions at national as well as regional levels. Despite notable increases in recent years, FDI flows in Africa remain very low in comparison to Asia and other regions and tend to be concentrated regionally (i.e. North Africa) and

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[7] See UN-DESA, "Implementation of the Monterrey Consensus: A Regional Perspective", Department of Economic and Social Affairs, United Nations, New York, 2005.

[8] UNECA, "Financial Systems and Domestic Resource Mobilisation for Economic Development in Africa", a Regional Workshop organised by ECA, Nairobi, 1-3 November 2004.

sectorally (i.e. in the extractive industries). FDI flows to the service sector in general, and the electricity, wholesale and retail sub-sectors in particular, have been on the rise in recent years, challenging the dominance of the extractive industry. This is due to privatization and liberalization of the sector as well as technological innovations, which have increased the range of tradable services. It is important for Africa to tap-up South-South FDI flows, especially from such countries as South Africa, China, India and Brazil.

International trade as an engine for development. Trade is considered as potentially the single most important source of external financing for developing countries. Therefore, WTO and related institutions, should put the interests of poor countries at the heart of their work programme to encourage trade within less developed countries and between developed and developing countries.

Africa's share in international trade has been declining over the last two decades. To realise Africa's commitment to achieving sustained economic growth and eradicating poverty with trade as a major source of financing, it is essential to: diversify exports; successfully conclude the Doha Development Round; and widen Africa's access, specifically, to developed countries' markets through reduction of tariffs and other barriers and through special and differential treatment. Meanwhile, an integrated continental market offers the best hope for Africa to build its manufacturing sector and diversify its economy away from primary products. This requires intensive efforts targeted at removing trade barriers within the continent, besides strengthening regional infrastructure.

Increasing international financial and technical cooperation for development. Official Development Assistance (ODA) plays an important role in complementing other sources of finance, especially in countries that lack capacity to attract FDI. Effective national leadership and ownership of plans with sound policies and good governance are essential to ensure ODA effectiveness. Developed countries have been repeatedly urged to honour the target of 0.7 percent of GNP as ODA to developing countries, and donors and recipients should work together to make ODA effective.

ODA represents the main source of development financing for many African countries, reaching over $23 billion for sub-Saharan Africa in 2003, and far exceeding debt service payments in that year. However, aid flows to Africa remain volatile and cannot meet the MDGs' financing needs even if the goal of 0.7 percent of rich countries' GNP is achieved. Therefore, Africa should ideally focus on attracting private flows, particularly foreign direct investment. Generally, FDI is less volatile, has less impact on domestic policy choices and has the potential to enhance productivity and growth through technology transfer. However, significant non-extractive FDI would only flow to developing countries that have already managed to build a conducive business environment, and poor countries might only afford to do so when they receive adequate aid. Therefore, effective aid management is critical for countries to reduce aid dependence and enhance their policy choices in the long run.

External debt and debt relief. The Monterrey Consensus state that debtors and creditors must work together to ensure sustainable debt flows to support public and private investment and prevent and resolve unsustainable debt situations. External debt relief can play a role in freeing resources for development financing through the Highly Indebted Poor Countries (HIPC) and other initiatives. In spite of these initiatives Africa's external debt has continued to increase at a high rate. There are huge differences in debt levels across countries, and debt sustainability in heavily indebted poor countries in Africa is a major constraint on development. Therefore, the international community has a responsibility to increase financing for debt relief because: debt reduction is more predictable than bilateral aid; has a longer-term horizon; reduces the transaction costs of managing aid, and acts as direct budget support, thus increasing recipient ownership. However, even if all the external debts of sub-Saharan Africa were relieved, the saving would fall far short of the amount required for meeting the MDGs.

As a matter of fact the HIPC has already helped to reduce the external debt burden of its beneficiary countries, many of which – for example, Uganda and Mozambique – have also been able to increase spending on the social sector. However, debt burden remains unsustainable for some of the HIPC countries, while annual debt service payments are higher or the same as before for others. Therefore, there is a need for improved debt sustainability analysis as well as expansion of the HIPC initiative to cover more heavily indebted African countries and reduce the burden of debt on economic and social spending. Meanwhile, an understanding has to be reached between lenders and borrowing countries for future borrowing to be tailored to country-specific circumstances, taking into account the quality of institutions, as well as vulnerability to shocks. This will assist future generations in developing countries to avoid problems of odious debt. Resource transfers beyond the sustainable debt-serving capacity of a given country should be in the form of grants.

Addressing systemic issues: Enhancing the coherence and consistency of the international monetary, financial and trading systems in support of development forms an integral part of efforts to address internal and external constraints on development within the Monterrey framework. Mutual accountability, harmonisation of aid modalities and policy coherence are among the main tools in addressing systemic issues. Several country-level and regional initiatives – such as African Peer review Mechanism (APRM) and The New partnership for Africa's development (NEPAD) – have created opportunities for African countries to improve governance and enhance policy coordination. To compliment this effort, Africa's development partners are urged to move faster to ensure that all their policies – on ODA, market access, and debt – are consistent with meeting the MDGs.

Conclusion

It follows from the discussion above that external and internal constraints on Africa's development can be more usefully analysed and simultaneously confronted within a holistic framework that underscores their interaction. Individual countries have the primary responsibility for developing long term plans to reduce dependence on foreign assistance and associated policy intervention through increased domestic resource mobilisation, retention and efficient allocation, and through attracting productive foreign flows, especially FDI. Regional integration will help in this direction through expansion of regional markets, facilitation of capital and labour movement and strengthening Africa's negotiating position in international fora such as WTO.