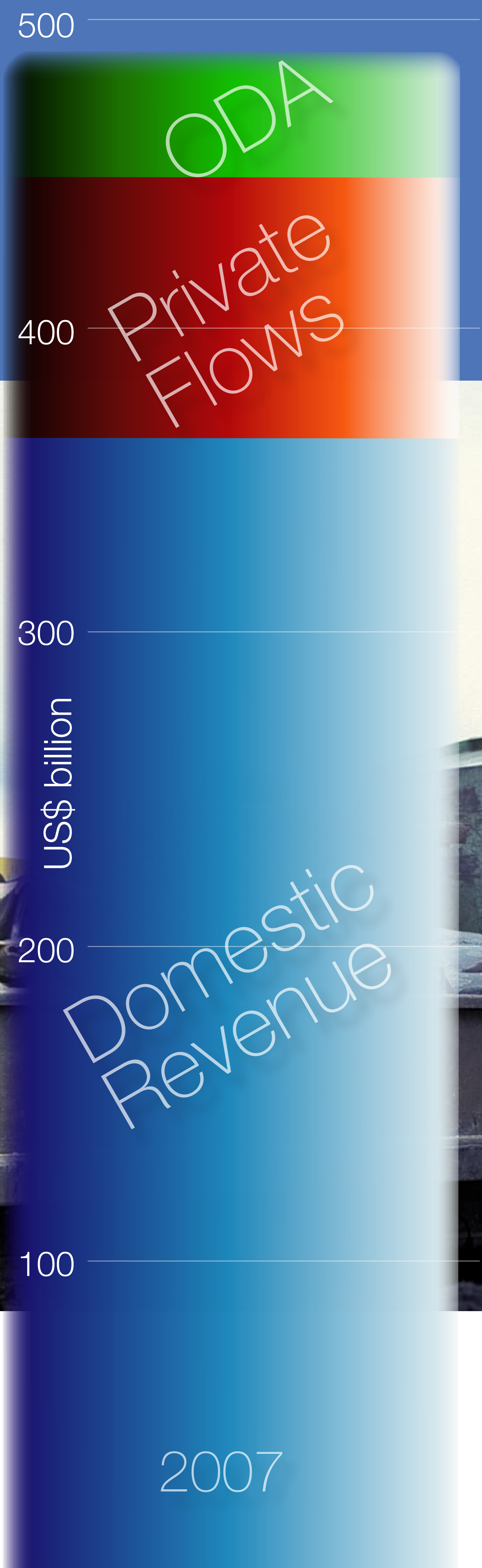
Development Finance in Africa:

From Monterrey to Doha



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Development Finance in Africa

This document was prepared for the 11th Meeting of the Africa Partnership Forum in Addis Ababa on 17-18 November 2008, and is part of a larger 'Mutual Review of Development Effectiveness' (MRDE), undertaken jointly by the UN Economic Commission for Africa and the OECD.

There are four main sections to the MRDE: Sustainable Economic Growth, Human Development, Governance and Capacity Development, and Development Finance. A list of all the focus issues under these four sections is at Appendix 1. The full report will be available in January 2009 www.uneca.org or www.africapartnershipforum.org.

Contents

Note: The annexes contain more detailed analyses of the focus issues. They follow a common format:

I. Overview of commitments
II. What has been done to deliver on these commitments?
III. What are the results?
IV. What are the key priorities?

Executive Summary

The Monterrey Consensus of 2002 recognised the importance of different sources of development finance, including domestic savings and government revenue mobilisation, private capital flows, and official development assistance, alongside measures to reduce external debt. This provides the framework for this paper, both in the run-up to the Doha Follow-up International Conference on Financing for Development in November/December 2008, and in the context of current global developments.

2. This Executive Summary is intended to provide a broad overview of the picture as a whole over the period since 2002, and the key priorities as we approach Doha. Detail is provided under the 4 'focus issues' which follow. It incorporates data available as at 7 November: domestic revenue and private capital flows in 2007, and aid statistics for 2007. An additional 'focus issue' on the implications for Africa of current global developments has been added.

3. It starts with a broad overview of the main commitments from both Africa and development partners, and what has been done to deliver these. It then assesses the results, noting a substantial increase in the availability of development finance since 2002, driven by an increase in domestic revenue – which is by far the most significant source of development finance. It notes the increase in private capital flows, which have overtaken official development assistance in volume, and also the increasing diversity of financing sources. It assesses the impact of the financial and economic crisis, and concludes by suggesting policy priorities for both Africa and development partners, in particular in the context of Doha.

Commitments

4. African leaders had before Monterrey already emphasised the importance of domestic savings and improvements in public revenue collection, as well as private capital flows, in the NEPAD founding statement of 2001. They have re-emphasised their commitment to mobilize additional domestic resources, and to improve the investment climate in order to attract increased domestic and foreign private investment, at successive points since then, including the AU Heads of State Declaration of 2005.

5. Commitments from development partners have come in 2 main 'waves'. During or after Monterrey in 2002, they entered into substantial new commitments to increase official development assistance (ODA), though without making specific commitments in relation to Africa, including an EU commitment to reach an interim target of 0.39% as a proportion of gross national income (GNI) by 2006. They also pledged to improve aid effectiveness. An important second wave of commitments, in relation to ODA volumes, aid effectiveness, innovative financing mechanisms and debt relief, came in 2005 – including a more specific focus on Africa, and with important separate commitments on multilateral trade reform at the Hong Kong WTO Ministerial of the same year:

(i) The EU committed to a further increase in ODA to 0.56% of GNI by 2010, with half of this increase going to sub-Saharan African countries. Other development partners also committed themselves to increase their ODA to sub-Saharan African countries, and the 2005 Gleneagles G8 Summit estimated that the various commitments which had been made would lead to an increase of ODA to Africa of US$25 billion a year by 2010 compared to a 2004 baseline;

(ii) Both development partners and African governments entered into substantial commitments to improve aid effectiveness in the Paris Declaration, based on an agenda of ownership by developing countries, alignment with national development strategies, harmonisation of donor actions, results and mutual accountability (the Accra Agenda for Action of 2008 contains further commitments on aid effectiveness);

(iii) Development partners committed themselves to the development of innovative financing mechanisms as a way of helping to deliver the complementary finance needed to achieve the MDGs;

(iv) Development partners also committed themselves to a new Multilateral Debt Relief Initiative involving the cancellation of outstanding debts of all post-completion Highly Indebted Poor Countries (HPICs) to the IMF, IDA and the Regional Development Banks.

DELIVERY

6. African governments have improved macro-economic and fiscal management, and succeeded in raising the ratio of government revenue from an average of 21% to over 25% of GDP between 2001 and 2007, although the range of these ratios varies considerably. Over half of Africa, including all of North Africa, are now collecting over 20% of GDP as domestic public revenue - though a quarter of governments in sub-Saharan Africa still collect below 15% of GDP in domestic revenue. Improved macro-economic management has, along with other factors including improved economic governance, been a key factor in improving the investment climate, and in helping to stimulate higher levels both of domestic savings and investment, and of foreign investment;

7. Development partners made significant progress towards meeting their Monterrey commitment to increase ODA by 2006. Sixteen of the DAC's 21 member countries which had agreed on targets during or after Monterrey reached them in 2006. EU net disbursements in 2006 were equivalent to 0.44% of combined GNI compared to a commitment of 0.39% announced at Monterrey. The picture on the 'second wave' of commitments from 2005 is however more mixed:

(i) Rapid progress has been made in delivering additional debt relief through the Multilateral Debt Relief Initiative, which was implemented during 2006 at the IMF, IDA and the African Development Bank;

(ii) This, , along with substantial debt relief for Iraq and Nigeria, led to significant increases in global ODA/GNI in both 2005 and 2006 (as debt relief is scored for ODA purposes in its entirety at the time of debt cancellation), which was a key factor in delivering progress towards the 2002 commitments for 2006. However as debt relief returned to more normal levels in 2007, the global ODA/GNI ratio fell, as did total ODA both globally and for Africa (more detail on the Africa statistics is now available, and is summarised at para 11 (ii) below). Very substantial increases in ODA excluding debt will be required to meet the 2005 commitments for 2010 both globally and in relation to Africa ;

(iii) The evaluation undertaken ahead of the Accra High Level Forum on Aid Effectiveness in September 2008 indicated slow progress against most of the specific targets for 2010 set out in the Paris Declaration. The detailed data shows some areas where the picture in Africa is the same as the picture globally (such as aid untying), but other areas where progress is slower, including some areas where although there has been progress globally, the position in Africa has got worse compared to the 2005 baseline (such as increasing the use of country system, and the coordination of donor missions and country studies).

(iv) Several innovative financing mechanisms involving new forms of taxation and securitised borrowing were launched in 2006, such as the airline ticket levy (which finances the purchase of drugs to help combat AIDS, TB and Malaria), the International Finance Facility for Immunisation and Advance Market Commitments. The EU carbon trading scheme that starts during the second trading period (2008-12) permits Member States to auction up to 10% of their carbon credits (more from 2013 onwards), which can potentially be used to finance development measures such as adaptation.

RESULTS

8. The results have been a substantial increase in the availability of development finance combined with a reduction in external debt. This has been driven by an increase in domestic revenue, which is by far the

most significant source of development finance in Africa. The increase in private flows has outpaced the increase in ODA, with result that private flows have overtaken ODA and are now the second most significant source of finance. There is also a growing diversity of sources of finance, including remittances and philanthropic foundations, non-DAC donors, and innovative financing mechanisms:

(i) Between 2002 and 2007, the combination of domestic public revenue, private external flows, and ODA from OECD DAC donors, rose from US$176 billion to US$487 billion for Africa as a whole; within this the total for sub-Saharan Africa rose from US$99 billion to US$289 billion; the total for North Africa rose from US$77 billion to US$196 billion;

(ii) Domestic revenue accounts for around 75% of this total, for Africa as a whole. For North Africa the figure is around 85%; for sub-Saharan Africa the figure is around 70%;

(iii) In 2002 ODA flows were larger than private external flows. By 2004 the level was similar. By 2005 private external flows had overtaken ODA. In 2007 private flows were twice as large as ODA flows;

(iv) The increases in remittances, philanthropic flows, and ODA from non-DAC donors, combined with new flows from innovative financing mechanisms, added to total available finance.

9. **Domestic revenue**: The combination of economic growth and increased revenue effort led to an increase in domestic revenue for Africa as a whole from US$138 billion (the average figure over 1997-2002) to US$367 billion in 2007. Within this overall picture, the rate of increase in sub-Saharan Africa was slightly higher - from US$70 billion in 1997-2002, to US$202 billion in 2007; the comparable figures for North Africa are US$67 billion in 1997-2002, and US$165 billion in 2007. The increase has been uniform across all groupings of countries. Both resource-rich and other countries have achieved high revenue collection and while higher commodity prices account for most of the increase in the former group, for the others most of the improvement can be attributed to more effective tax administration;

10. **Private external flows**: FDI inflows to Africa rose from US$13 billion in 2002 to US$45 billion (estimate) in 2007. The surge was in large part related to investments in extractive industries, but FDI also rose in various service industries. Other net private capital flows (portfolio equity, bank debt and bonds) also increased sharply from US$4 billion in 2002 to over US$35 billion in 2007. Total private external flows excluding remittances and philanthropic sources thus rose from US$17 billion in 2002 to US$81 billion in 2007 - a new record level. Within this figure, North Africa accounted for about a third (up from US$7.4 billion in 2002 to US$28 billion in 2007) and sub-Saharan Africa for two-thirds (up from US$10 billion in 2002 to US$53 billion in 2007 – all figures rounded).

11. **Development assistance -** ODA volumes, aid effectiveness, innovative financing and debt relief:

(i) Progress in meeting the Monterrey commitments led to an overall increase in ODA from US$60 billion to US$105 billion in nominal terms **between 2002 and 2006**. ODA to Africa as a whole increased at a marginally higher rate over this period, from US$21.7 billion to US$43.5 billion, and Africa's share of global ODA increased slightly from 35.8% to 41.2%. Within this overall picture, ODA to sub-Saharan Africa increased from US$18.9 billion to US$40 billion. Much of the increase in 2005 and 2006 was accounted for by debt relief in these 2 years – development assistance excluding debt relief rose sharply from US$18.5 billion in 2002 to US$25.2 billion in 2004, but then more slowly to US$28.3 billion in 2006;

(ii) **In 2007**, net ODA to Africa fell to US$38.7 billion. This corresponds to a fall of 18% in real terms, mostly due to exceptional debt relief especially for Nigeria in 2006. If debt relief is excluded, then net ODA to Africa in fact rose significantly from US$28.3 billion to US$35 billion – an increase of around 24% in nominal terms (equivalent to 12% discounting price and exchange rate movements). Within this overall picture, net ODA to sub-Saharan Africa also fell, from US$39.9 billion to US$34.2 billion, as debt relief returned to the lowest level since 2002 - though net ODA excluding debt relief similarly rose significantly from US$ 24.8 billion to US$ 30.5 billion – an increase of around 23% (equivalent to 11% discounting price and exchange rate movements). Africa's share of global ODA fell from 41.2% to 36.9%.

(iii) The September 2008 Accra High Level Meeting on Aid Effectiveness concluded that progress on the agenda set out in Paris in 2005 had been insufficient and needed to be accelerated in key areas, including increasing the medium-term predictability of aid, aligning to country systems, and improving coordination across an increasingly fragmented aid architecture;

(iv) The innovative financing mechanisms launched in 2006 are starting to generate additional resources – for instance the US$1.5 billion committed under the Advanced Market Commitments Scheme to support the development of vaccines, US$1.2 billion under the International Finance Facility for Immunisation, US$0.3-0.4 billion generated by the air ticket levy, and the additional revenue generated by emissions trading - specifically the auctioning of emission allowances;

(v) The MDRI debt relief initiative has substantially lowered debt and debt service ratios for qualifying countries. The net present value (NPV) of debt stocks in the 31 eligible HIPCs are projected to decline by about 90% after the application of the MRDI. The debt service ratio for these countries is estimated to have declined from an average of around 17% in 1998-99 to around 4% in 2006.

12. **Other financing sources**:

(i) Remittance flows are becoming an increasingly important source of finance in Africa. Between 2002 and 2007 recorded remittance flows to Africa increased from US$12.9 billion to US$36 billion (North Africa US$7.9 billion to US$19 billion; sub-Saharan Africa from US$5 billion to US$19 billion (figures which it is believed could be even higher if unrecorded flows were included);

(ii) There is a dynamic and growing array of private philanthropic foundations increasingly active both globally and in Africa.

(iii) ODA from non-DAC donors is also growing, both from EU members who are not members of OECD but who are committed to the common EU target, and from donors from other regions.

EMERGING CHALLENGES

13. The last 12 months have seen the rapid emergence of new challenges which are already having a profound impact on the development agenda. Many countries in Africa have been hard hit by the food and fuel price shocks of the past year, causing fiscal and inflationary pressures, and balance of payments problems. The scale of the adaptation costs which they face due to the impact of climate change is now becoming increasingly clear. And the current financial and economic crisis is bound to have important implications for the availability of all sources of development finance, including the domestic revenue base:

(i) The slowdown of growth in the global economy will inevitably affect growth prospects, and therefore domestic revenue: the latest IMF forecasts for Africa have been revised substantially downwards and now indicate a slowing of growth to about 5.2% in 2008 and 4.7% in 2009, down from 6.1% in 2007 (for sub-Saharan Africa, the IMF projects a fall from 6.8% in 2007 to 5.4% in 2008, and 5.0% in 2009;

(ii) Private capital flows – which have become the second most significant source - will come under pressure at least in the short term, making it difficult to sustain the recent positive trends;

(iii) Weakening commodity prices are likely to lead to deterioration in terms of trade, adding to the pressure on the international reserve position of a number of countries;

(iv) Local banking sectors and financial markets in the larger and more globally inter-connected countries are likely to be affected by financial market fallout – with potential knock-on effects in other countries;

(v) Slower growth in OECD economies will reduce the volume of ODA implied by commitments denominated in GNI. Despite this, tightening fiscal pressures in donor countries will add to the challenge of meeting these commitments within current target-dates;

(vi) Remittances, which have become an increasingly important source of inflows, will also come under pressure due to tighter labour market conditions in OECD economies;

(vii) At the same time, looking beyond the short term, and provided stability in macroeconomic management is maintained, Africa has the opportunity to become an increasingly attractive location for both domestic and international investors.

TOP POLICY PRIORITIES

14. **For Africa**, action on 4 fronts:

(i) Domestic revenue: Continue efforts to increase domestic revenue mobilization, to improve tax administration and the transparency and equity of tax policy, to combat tax evasion, and to improve financial management, in line with the Pretoria Communiqué (August 2008);

(ii) Private flows: Continue efforts to improve the investment climate to attract more domestic and foreign investment, as well as other flows such as bond and remittances;

(iii) Trade: Intensify efforts to promote regional trade, including through the development of regional infrastructure such as transport corridors and the promotion of a wider free trade area across different sub-regions;

(iv) Debt: Ensure that external debt positions remains sustainable.

15. **For development partners**, action on 6 fronts:

(i) Tax: Strengthen international action to combat harmful tax practices, and tax evasion and fraud, and to repatriate illegally acquired assets, through increased transparency and the exchange of information, and more effective control mechanisms;

(ii) Trade: Resist protectionist pressures, and intensify efforts to bring about a successful conclusion of the WTO Doha negotiations;

(iii) Financial stability: Introduce greater transparency and oversight in the international financial system in order to create financial stability for countries at all levels of development;

(iv) Aid: Deliver existing commitments on increased aid volume and improved aid effectiveness;

(v) Innovative financing mechanisms: Intensify efforts to facilitate and promote innovative financing such as the IFF, and to generate additional revenue from the carbon market, in order to provide adequate, predictable and additional funding to help meet the costs of climate adaptation;

(vi) Institutional architecture: Reform of multilateral institutions to ensure that they are responsive and effective in helping developing countries tackle both short-term crises and long-term development needs.

DEVELOPMENT FINANCE: OVERVIEW TABLES

(US$ billion, nominal)

Africa

	2002	2003	2004	2005	2006	2007
Domestic revenue	137.6[1]	168.0	209.8	267.6	321.6	366.9
Private flows	17.1	20.0	28.7	45.2	51.5	81.0
ODA	21.4	27.1	29.5	35.5	43.5	38.7
Total	**176.4**	**215.1**	**268**	**348.3**	**416.6**	**486.6**

North Africa

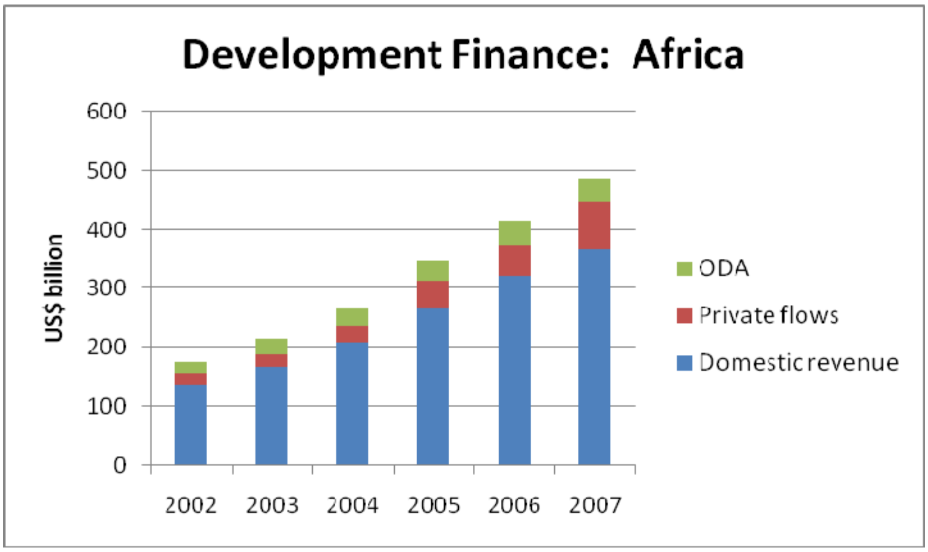
	2002	2003	2004	2005	2006	2007
Domestic revenue	67.2[1]	75.8	87.3	113.2	140.1	165.1
Private flows	7.4	3.3	6.5	15.3	21.1	27.7
ODA	2.3	2.2	3.0	2.6	2.7	3.2
Total	**76.9**	**81.3**	**96.8**	**131.1**	**163.9**	**196**

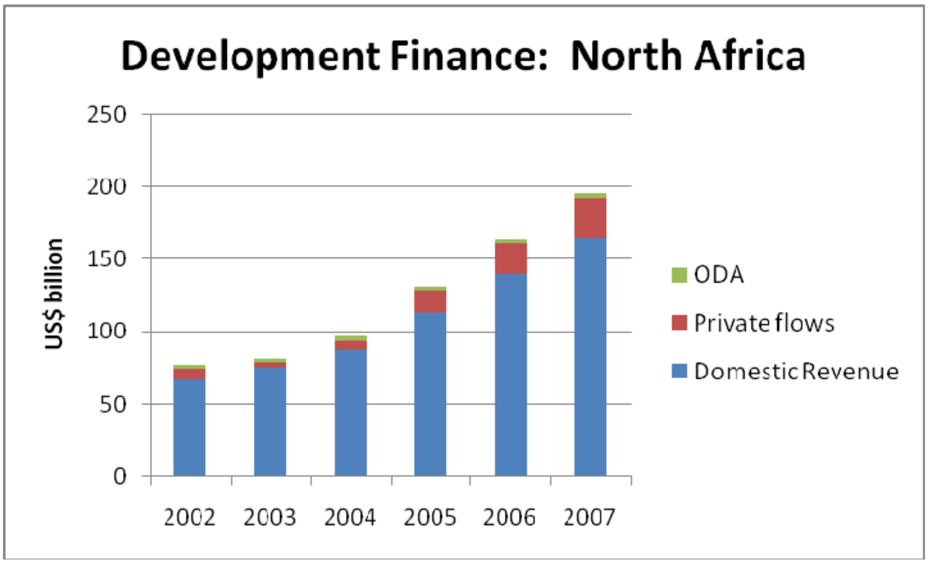
Sub-Saharan Africa

	2002	2003	2004	2005	2006	2007
Domestic revenue	70.5[1]	92.2	122.5	154.4	181.5	201.8
Private flows	9.7	16.7	22.2	29.9	30.4	53.3
ODA	18.9	24.5	26	32.2	40.0	34.2
Total	**99.1**	**133.4**	**170.7**	**216.5**	**251.9**	**289.3**

Sources: IMF Regional Economic Outlook Series; Middle East and Central Asia (May 2008), Sub-Saharan Africa (September 2008); World Bank, Global Development Finance (2008); OECD Development Co-operation Report, 2007 (published January 2008) and updates.

[1] This is an average for the period 1997-2002, based on data availability.


Development Finance: Africa
600
500
400
300
200
100
0
US$ billion
2002
2003
2004
2005
2006
2007
ODA
Private flows
Domestic revenue


Development Finance: North Africa
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US$ billion
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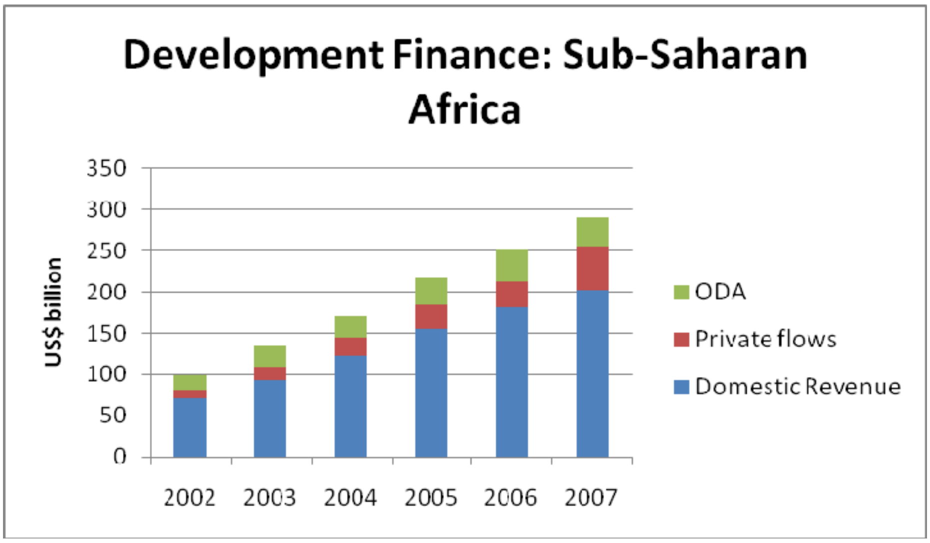
Private flows
Domestic Revenue


Development Finance: Sub-Saharan Africa
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Domestic Revenue

FOCUS ISSUE 1: DOMESTIC PUBLIC RESOURCES FOR DEVELOPMENT

I. Overview of commitments

Africa:

NEPAD Document, October 2001

- NEPAD's founding statement in 2001 identified domestic savings and improvements in public revenue collection as key resources to be supplemented by official development assistance, debt relief and private capital flows. The statement further underlined that improved governance is a prerequisite for increased capital flows.

AU Heads of State Declaration, July 2005

- African leaders resolved to mobilize additional domestic resources for financing of MDGs and called on the private sector to contribute more substantially to development on the continent and *to efforts to meet the MDGs.*

CAMEFII Declaration, November 2006

- At the Conference of African Ministers of the Economy and Finance (CAMEF II) Ministers made a commitment to put in place mechanisms for mobilization of domestic resources in order to ensure sustainability in the implementation of their socio-economic development agenda.

Development Partners:

Monterrey Consensus, 2002

- Development partners undertook to support efforts by developing countries to create the necessary internal conditions for mobilizing domestic savings, both public and private, sustaining adequate levels of productive investment and increasing human capacity, increasing productivity, reducing capital flight, encouraging the private sector, and attracting and making effective use of international investment and assistance. It was further emphasized that good governance is essential to effective resource mobilization and allocation.

G8 Summit Declarations, 2002-2007

- Leaders of G8 countries committed to support initiatives aimed at fostering efficient and sustainable regional financial markets and domestic savings and financing structures. In Potsdam in 2007, the G8 Finance Ministers committed to support the G8 Action Plan for Good Financial Governance in Africa and more specifically to support African countries in reforming their tax policies and tax administrations and to encourage African nations as well as donor countries to join the UN Convention against Corruption (UNCAC) which could contribute to the recovery of corruptly acquired assets.

World Summit Outcome, 2005

- Leaders resolved to support efforts of developing countries to create a domestic enabling environment for mobilizing domestic resources.

II. What has been done to deliver on these commitments?

Africa:

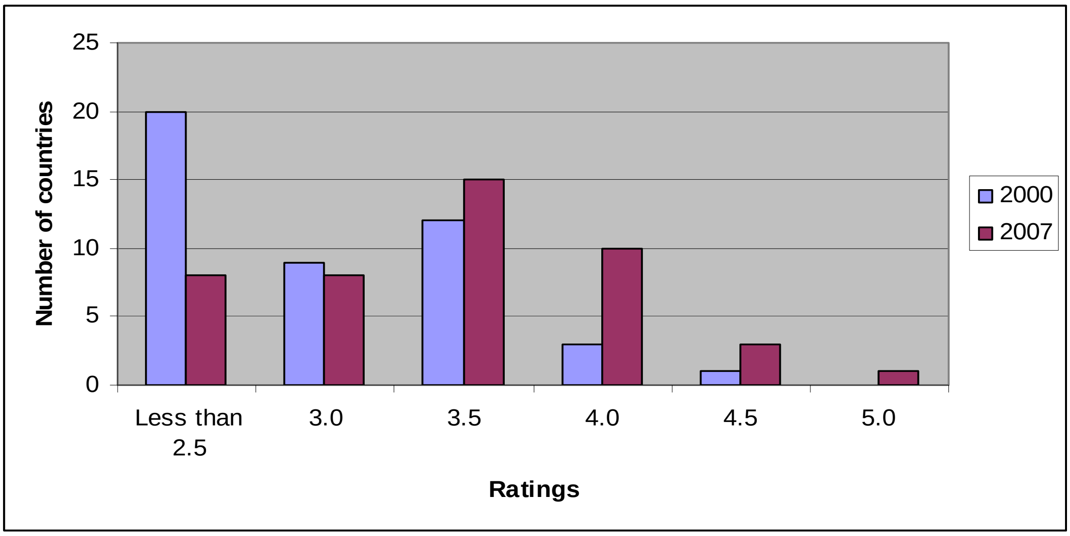
1. While external resource flows have an important supporting role to play in financing for development, long-term development processes can only be sustained through domestic resources. Unlike the other financing flows where there is a common understanding as to their coverage, the discussion of domestic resources is made complicated by the fact that sometimes this term refers to domestic savings, which consists of savings both by the private and public sectors, and sometimes the term refers only to public sector savings. Given the complexity of the determinants of domestic savings (only some of which can be affected by public policy), this report, which focuses on monitoring commitments, concentrates on the more narrow definition of domestic resources (i.e. public sector savings), which is referred to in the rest of this section as "government revenue". Besides tax policy and tax administration which is the core of this section, the report also touches upon other relevant considerations such as the efficiency of government spending, the management of natural resources, and capital flight -- which denies African economies a considerable amount of resources.

2. *Revenue Mobilisation Efficiency* The majority of African countries have experienced an increase in government revenue -- despite i) a fall in the share of trade taxes due to trade liberalization and ii) declining corporate tax rates in an effort to attract foreign direct investment. Virtually all countries in Africa have broadened their tax base through both the adoption of a value-added tax (VAT), although VAT coverage remains relatively limited) and a higher reliance on direct taxes such as personal and corporate income taxes.

3. Assessment by the World Bank shows a gradual improvement in revenue mobilisation efficiency in many African countries.[2] As shown in Figure 1, in 2000 the performance of almost half of sub-Saharan African countries was rated less than 2.5 – or strongly unsatisfactory – with tax systems characterized by a narrow tax base, many exemptions and an overreliance on taxes on foreign trade. Tax administration was generally weak due to complex laws, poor information systems, corruption, weak capacity and political interference. In contrast, by 2007 the number of sub-Saharan countries rated 3.0 or lower -- strongly to marginally unsatisfactory -- had declined from 29 to 16. The rating for the majority of countries was generally satisfactory – at 3.5 or higher -- indicating a broader tax base with a significant amount of revenue generated by low-distortion taxes such as VAT and company and personal income taxes and much improved tax administration.

[2] The Country Policy and Institutional Assessments (CPIA) by the World Bank rate how the quality of a country's present policy and institutional framework fosters poverty reduction and sustainable growth. The African Development Bank has a similar system of ratings and, for most countries, the ratings by the two institutions show a very high correlation for most indicators. The 16 CPIA criteria are grouped into four clusters: Economic Management, Structural Policies, Policies for Social Inclusion and Equity, and Public Sector Management and Institutions. For each criterion, countries are rated on a scale of 1 (low) to 6 (high).

Figure 1: Rating of Revenue Mobilization Efficiency in sub-Saharan Africa



Source: World Bank estimates.

4. In a number of countries where revenues relative to GDP are extremely low and where tax administration is weak, governments have established autonomous revenue agencies[3] to make tax administration more efficient and effective. While evidence is inconclusive whether the establishment of revenue authorities offers a quick fix to a country's revenue and tax administration problems, it has the great merit of facilitating the degree of managerial autonomy needed to improve efficiency in the absence of the lengthy process of reforming the civil service.

5. *Other Financial Management Reforms.* With the support by its development partners, Africa has redoubled efforts to address weaknesses in public financial management (PFM) systems. An assessment of the changes in PFM system performance for a pool of fifteen highly-indebted poor countries (HIPCs) for the period 2004-06 show a moderate improvement compared to 2001-04.

6. *Management of Natural Resources.* Given the importance of natural resources in Africa, the quality of their management plays a critical role on government revenue mobilization. As of late 2007, sixteen African countries have either been accepted as candidate countries or are being considered for candidacy to the Extractive Industries Transparency Initiative (EITI), which was launched in 2003 to support improved governance in resource-rich countries through the verification and full publication of company payments and government revenues from oil, gas and mining. Several among these countries have issued EITI reports and undergone a validation process. More recently, Nigeria has taken the additional step and moved to EITI "Plus" which, in addition to capacity building, public information and the reconciliation of the accounts of the government and participating companies, is proceeding to undertake the financial audits of these accounts.

7. *Capital Flight.* Notwithstanding the different conceptual approaches to capital flight,[4] what emerges from all the studies is that capital flight is currently diverting a large amount of resources from African and other countries that are in urgent need of financing for development. Nigeria, along with Peru and the Philippines, are three countries that have succeeded in recovering part of looted

[3] In Africa, fourteen countries have set up autonomous revenue authorities, most of them in English-speaking countries (Ghana, Uganda, Zambia, Kenya, Malawi, Tanzania, South Africa, Rwanda, Zimbabwe, Ethiopia, Sierra Leone, Lesotho, The Gambia and Mauritius in the chronology the agencies were created). Fjeldstad (2008).

[4] There is the need to differentiate between an outflow of funds from criminal sources and corruption and more "normal" outflows that are caused instead by the lack of financial market depth in developing countries, which influences the risk-adjusted return to assets and encourages capital outflows in search of higher returns.

resources. It took Nigeria five years to obtain a repatriation decision from one country holding its corruptly acquired assets. Repatriation finally took place in 2005 and 2006, for a total of US$505.5 million.

8. *Mobilisation of Other Sources of Fund.* The Pan-African Infrastructure Development Fund was established in 2007 with the purpose to generate funding from state pension funds (South Africa Government Employees Pension Fund and Ghana's Social Security and National Insurance Trust and Metropolitan Holdings) and other financial entities. The Fund has already mobilized US$625 million and identified 20 projects for financing.

9. *Tax Governance and Accountability.* Realising that taxation is a fundamental part of state building, 29 African countries recently established the African Tax Forum to take the lead on tax matters related to Africa and support policy development and capacity building for national tax agencies (see Box 1 below).

Box 1: African tax reform

A major Africa-wide conference on tax, governance and capacity development was held in South Africa in August 2008. This brought together Tax Commissioners and high level officials from 30 African countries, as well as donor countries and international organizations. The meeting's key outcome, announced in the Pretoria Communiqué, was the creation of a Steering Group of African Commissioners to launch an African Tax Administration Forum. The Forum will act as a focal point for exchanging experiences on good practices, benchmarking performance, improving co-operation between and **building capacity** for African Tax Administrations. (View the Pretoria Communiqué at: http://www.oecd.org/dataoecd/1/33/41227692.pdf)

The OECD's Centre for Tax Policy Administration (CTPA) worked with the South African authorities in support of this **African led** initiative, and has had a dialogue with tax authorities in Southern and Eastern Africa over a number of years, sharing experience on tax policy and capacity building in tax administration. Policy dialogue focuses on issues of particular relevance to Africa, including transfer pricing regimes, tax treaties, capital flight, auditing multinationals and tax reforms.

Development Partners:

10. *From a Focus on Revenue Targets to Broader Support.* During most of the 1990s and the early part of the present decade, the emphasis on macroeconomic stability to correct severe imbalances in the fiscal position of many African countries has led to: i) the setting of ambitious overall revenue targets (measured as the tax-to-GDP ratio) and coercive tax enforcement; ii) a more narrow focus on technical considerations at the expense of broader governance and accountability considerations; and iii) poorly designed taxes that may have exacerbated the negative effects of the tax system on the economy. Despite efforts by African governments to increase tax revenue mobilisation, there is the concern that very limited resources have been devoted by development partners to tax-related assistance. The "Pretoria Communiqué" issued at the end of the International Conference on Taxation, State Building and Capacity Development in Africa held in South Africa (August 2008) suggests that in 2005 only 1.7% of the US$7.1 billion spent on bilateral aid for government administration, economic policy and public sector financial management went to tax-related assistance.

11. The much-improved macroeconomic frameworks in most African countries as evidenced by low inflation and significantly improved fiscal positions[5] have made room for a more comprehensive

[5] The sharp rise in food and fuel prices, which started in late 2007 and only began to recede more recently, has led to a significant deterioration of both inflation rates and fiscal positions of many African countries.

reform of both tax policy and tax administration as discussed above. Development partners have, for instance, fully endorsed the creation of the African Tax Administration Forum. The G8 Action Plan for Good Financial Governance in Africa launched by the G8 Finance Ministers in 2007 encouraged African countries to make use of regional networks and international knowledge on tax policy and tax administration in order to bolster domestic expertise and to participate in bilateral and international initiatives, such as the International Tax Dialogue (ITD)[6].

12. *Initiatives on Governance and Resource Management.* There is now broad commitment by both countries and their development partners to use the Public Expenditure and Financial Accountability (PEFA) "public financial management performance measurement framework" to measure and monitor the strength of country PFM systems and for donors to commit to using those systems in the context of the Paris Declaration.

13. The Stolen Asset Recovery (StAR) initiative was recently launched jointly by the UN Office on Drugs and Crime (UNODC) and the World Bank to i) use both institutions' convening power to enhance cooperation between developed and developing countries on StAR and persuade all countries to ratify and implement the UN Convention Against Corruption (UNCAC); ii) build partnerships aimed at enhancing legislative, investigative, judicial, and enforcement capacity in developing countries to enable them to successfully recover the stock of corruptly acquired assets kept either in the home country or secreted abroad, while deterring new outflows; and iii) help concerned developing countries to monitor the use of recovered assets, as was done in Nigeria.

14. The fight against tax fraud and evasion was recently given renewed political impetus when finance ministers from 17 OECD countries agreed to step up pressure on offshore financial centres and called on the OECD to assess offshore territories for full compliance with exchange of information requirements.

III. What are the results?

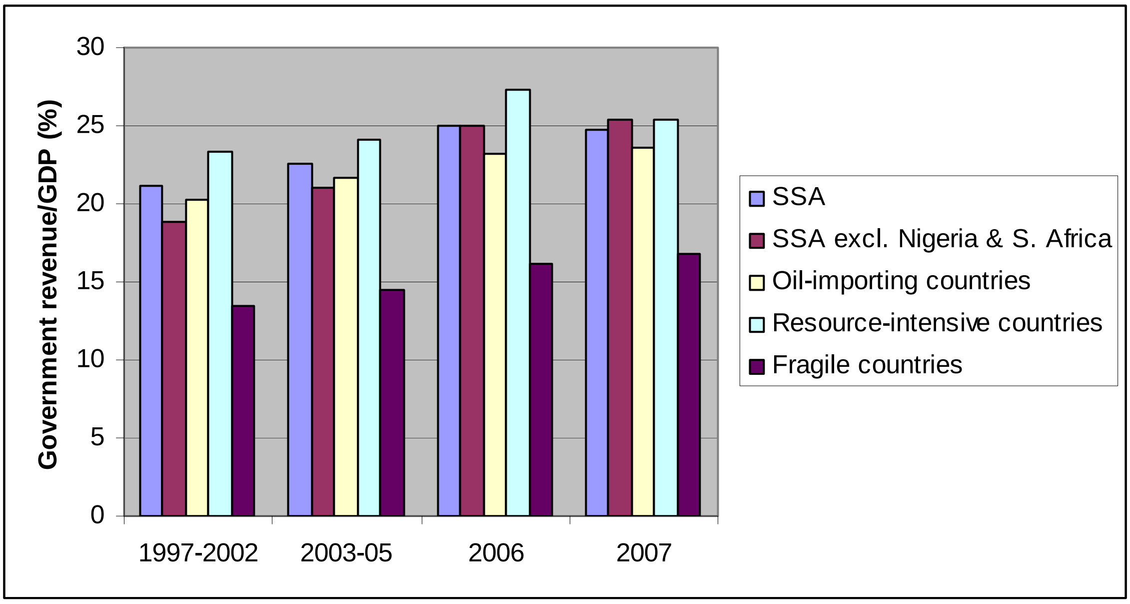
15. After remaining basically unchanged between the early 1990s and early 2000s, total government revenue as a share of GDP has been steadily improving in most African countries. As shown in Figure 2, domestic revenue — defined as tax and non-tax revenues excluding grants — increased by almost 4 percentage points of GDP between the pre-Monterrey period and 2007, reaching an average of over 25% in 2007 for sub-Saharan Africa as a whole. Excluding Nigeria and South Africa, the increase in government revenue expressed as a share of GDP rose even more sharply for the rest of sub-Saharan Africa, increasing from 18.8% as an average for 1997-2002 to 25.4% in 2007, equivalent to over 6 percentage points of GDP.

16. The increase has been uniform across all groupings of countries (see Annex Table 1 in the Data Appendix for more detail). While several *oil-exporting countries* such as Angola, The Republic of Congo and Equatorial Guinea generate over 40% of GDP as public revenue from natural resource taxes such as income from production sharing, royalties and corporate income tax on oil and mining companies, revenue mobilization in oil-exporting countries as a group is only slightly higher than for other countries on account of a more moderate performance by Nigeria. Thus, while the boom in oil and commodity exports and higher commodity prices have undoubtedly contributed to the strong revenue mobilisation performance of resource-intensive countries, improvement in other African countries can be attributed to more effective tax administration. It is worth noting that as a group,

[6] The International Tax Dialogue (ITD) is a collaborative arrangement involving the Inter-American Development Bank, IMF, OECD, European Commission and World Bank Group to encourage and facilitate discussion of tax matters among national tax officials, international organisations, and a range of other key stakeholders. Twenty-one African countries are now ITD participant countries.

fragile countries (most of which are either post-conflict countries or countries under severe social and political tensions) also managed to increase their government revenue mobilisation over recent years with an increase equivalent to over 3 percentage points of GDP. The improvement would have been sharper if one rapidly deteriorating Africa country, whose public revenue plummeted from over 24% of GDP in the pre-Monterrey period to an estimated 6% in 2007, had been included.

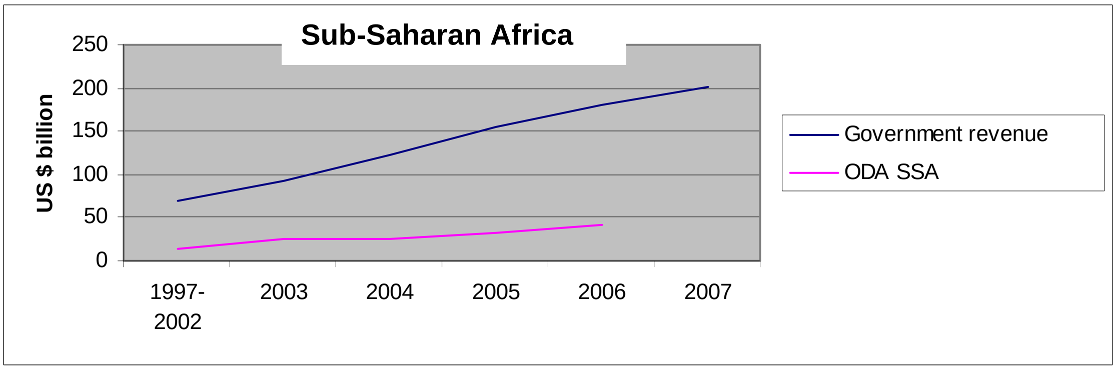
Figure 2: Government Revenue excluding Grants (% of GDP)

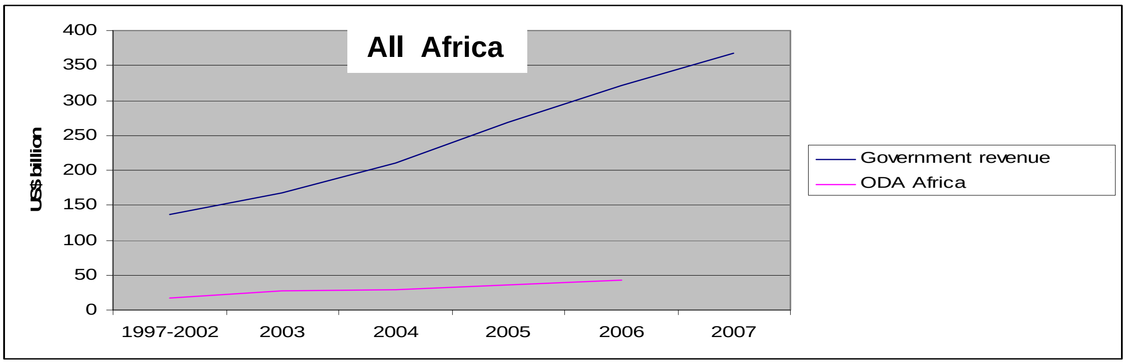


Source: IMF Regional Economic Outlook: Sub-Saharan Africa, various issues.

17. In recent years, the discussion on financing development and MDG-based targets has tended to focus on external resources – while neglecting the vital role of domestic revenue. Mobilising domestic revenue has usually been referred to as either i) a means of covering recurrent expenditures or ii) a long-term option allowing developing countries to eventually become less dependent on aid. Low or stagnant growth in the 1980s and part of the 1990s, declining import taxes following trade liberalisation and efforts to downsize governments in many African countries have contributed to the limited focus on the role of domestic revenue. Yet Africa's improved performance in this area has enabled it to double its revenue collection to US$202 billion in 2007 -- six times the volume of net ODA in the same year (Figure 3)**.** North Africa, where domestic revenue exceeds 20% of GDP in all countries, generated approximately US$140 billion of government resources in 2006, further increasing the gap between government revenue and ODA across Africa as a whole. Table 1 completes the picture, showing overall trends in aggregate domestic public revenue over the past decade.

Figure 3: Trends in Government Revenue and ODA Disbursements (US$ billion)





Source: IMF, Regional Economic Outlook: Sub-Saharan Africa, October 2008 and OECD-DAC database

Figure 4: Recent Domestic Public Revenue Mobilisation in Africa (US$ billion)

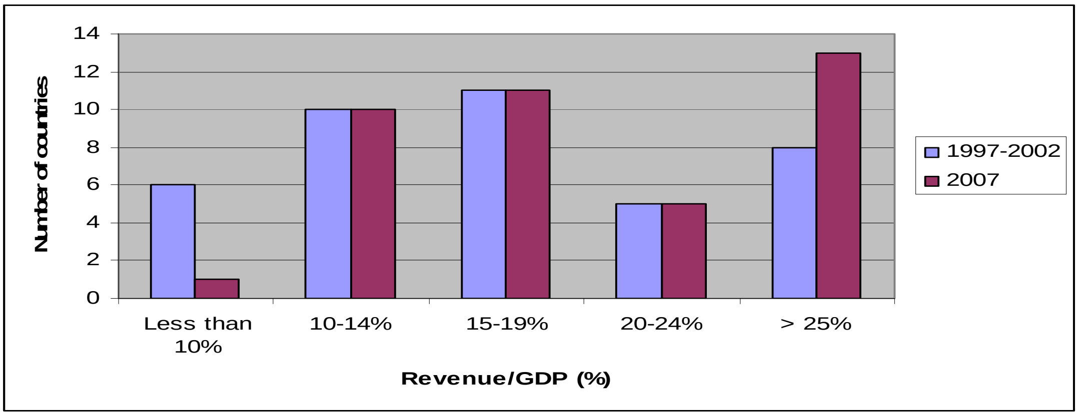
	1997-2002	**2003**	**2004**	**2005**	**2006**	**2007**
Sub-Saharan Africa	70.5	92.2	122.5	154.4	181.5	201.8
North Africa	67.2	75.8	87.3	113.2	140.1	165.1
All Africa	**137.6**	**168.0**	**209.8**	**267.6**	**321.6**	**366.9**

Source: World Bank, World Economic Indicators 2008: IMF Regional Economic Outlook Series: Sub-Saharan Africa (October 2008) and Middle East and Central Asia (May 2008)

18. The tax base in most sub-Saharan African countries continues to shift away from trade taxes as their principal revenue source, although the pace of this shift has slowed in recent years. The declining reliance on trade tax revenues has been the product of trade liberalization policies, most of which were initiated in the 1990s. Further trade liberalization, for instance in the context of the Economic Partnership Arrangements being negotiated by the European Union and ACP countries, will thus intensify the need to enhance domestic taxes and improve the management of trade tax exemptions. This will often involve strengthening the indirect tax system, including the Value Added Tax (VAT). Presently, 34 SSA countries and all North African countries except Libya have adopted the VAT at an unweighted average rate of 16%.

19. In spite of broad-based improvement in revenue collection, one-fourth of SSA governments still collect public revenues totalling less than 15% of GDP, a level considered as a minimum needed to cover the state's basic functions. 40% of African countries, including the oil-rich nations, North Africa, Southern Cone countries and a few others, are collecting revenues of more than 20% of their GDP (Figure 4), with the North African economies averaging above 30%. It is also worth noting that in 2007 no African country (with one exception) collected less than 10% of GDP in public revenue in 2007, in stark contrast to the pre-Monterrey period when six SSA countries, most of them emerging from conflict, collected less than 10% of GDP in public revenue.

Figure 4: Country Distribution of Revenue/GDP Ratios



Source: IMF Regional Economic Outlook: Sub-Saharan Africa, various issues.

20. A more detailed classification of countries (Figure 5) shows that among the group of countries that generate less than 15% of GDP in public revenue figure several high-performing countries such as Burkina Faso, Ethiopia, Madagascar, Mozambique, Rwanda, Tanzania and Uganda, raising the issue whether larger aid flows may undermine recipient countries ability and incentives to raise domestic revenue. An analysis by UNECA that plots data on average aid/GDP ratio and the ratio of government revenue to GDP across African countries over the period 1984 to 2006 shows that there is no systematic relationship between the two variables (Figure 6)[7]. The fact that the highly-performing countries mentioned above (as a group) only experienced an increase in public revenue mobilization of less than 2 percentage points of GDP -- or half the increase of sub-Saharan Africa -- warrants further analysis, in particular as regards the more recent period which saw a sharp increase in ODA, particularly to strong performers[8].

[7] The analysis showed a low correlation coefficient of -0.10 which is also statistically insignificant at conventional levels.

[8] The analysis would also need to take into account the determinants of tax revenue that depend on the structure of production and exports. For instance, a larger agricultural sector or low exports negatively impact tax mobilization while larger imports or a more important manufacturing sector tend to boost tax revenue.

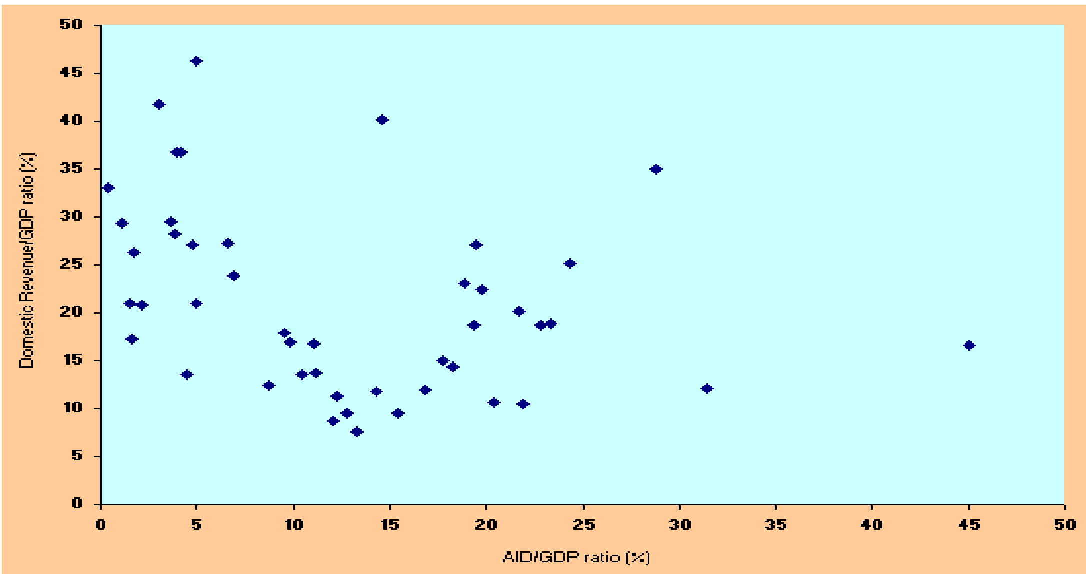
Figure 5: Government Revenue as a Share of GDP
(Average 2006-07, percent)

14 countries	14 countries	23 countries	
- Burkina Faso	- Benin	- Algeria	- Lesotho
- Central Africa Rep.	- Burundi	- Angola	- Libya
- Comoros	- Cameroon	- Botswana	- Mauritania
- Congo, Dem. Rep. of	- Chad	- Cape Verde	- Morocco
- Ethiopia	- Cote d'Ivoire	- Congo, Rep. of	- Namibia
- Guinea	- Guinea Bissau	- Egypt	- Sao Tomé & Príncipe
- Madagascar	- Liberia	- Equatorial Guinea	- Senegal
- Mozambique	- Mali	- Eritrea	- Seychelles
- Níger	- Malawi	- Gabon	- South Africa
- Rwanda	- Mauritius	- Gambia, The	- Swaziland
- Sierra Leone	- Nigeria	- Ghana	- Tunisia
- Tanzania	- Sudan	- Kenya	
- Uganda	- Togo		
- Zimbabwe **Less than 10%**	- Zambia		
10 to 15% of GDP	**15 to 20% of GDP**	**More than 20% of GDP**	

Note: Zimbabwe, which traditionally mobilised over 25% of GDP, experienced a sharp drop in 2007 because of the political crisis.

Source: IMF World Economic Outlook – Sub-Saharan Africa (October 2008).

Figure 6: Aid and Government Revenue in Africa



Source: Computed using data in African Development Indicators

Domestic savings

21. The previous section discussed Africa's positive performance in domestic public revenue collection. But with the exception of resource-rich countries and a few other countries, overall savings remain very low. As shown in Table 2, most of the increase in the domestic savings rates in recent years reflects the performance of resource-rich countries, thanks to buoyant prices of crude oil and other primary commodities. For non-resource-intensive countries, the overall domestic savings rate has hardly moved in spite of important progress in public revenue mobilisation. As a group, savings

rates in fragile states have declined sharply in recent years compared to the pre-Monterrey period. Eight countries, seven of which are classified as fragile countries, have negative savings ratios. Sub-Saharan Africa's low savings rates contrast sharply with the significantly higher savings rates of other developing regions including North Africa.

Table 2: Gross Domestic Savings
(% of GDP)

	1997-2002	**2005-07**
Sub-Saharan Africa	18.1	23.8
- Resource intensive countries	26.6	37.5
- Non-resource intensive countries	15.0	15.6
SSA Low-income countries	*(7.1)*	*(10.0)*
Middle-income countries	*(19.3)*	*(19.3)*

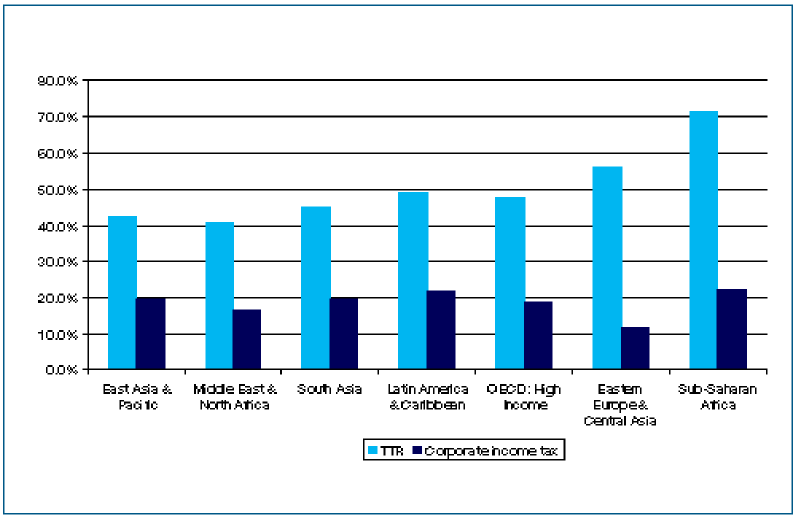
Source: IMF, Regional Economic Outlook – Sub-Saharan Africa (October 2008)

22. The success of several countries in Africa in raising domestic revenue, boosted in part by strong commodity prices, underscores the importance of and progress made in strengthening tax policy and tax administration. Sustaining and extending this effort should be an area of greater policy focus by African states and development partners. First, expanding domestic revenue mobilisation would contribute to create the fiscal space for Africa's enormous development needs such as covering overhead and maintenance requirements of additional aid-financed projects or mitigating the volatility and uncertainty of aid flows. In addition to sustaining overall revenue mobilisation efforts, African countries will also need to increase non-trade tax revenue -- which currently accounts for about one-third of total tax revenue – and rationalise tax exemptions. Further trade liberalisation with the European Union and the continued efforts by other trading blocs to compete for foreign direct investment via lower corporate income taxes will put continued downward pressure on total tax revenue mobilisation. Lastly, the sharp increase in food and fuel prices in the last year have forced several countries to reduce import duties and consumption taxes on these strategic products and, as a result, overall public resource mobilisation has slackened somewhat in 2008.

23. In their effort to raise government revenue, African countries will need to address a number of challenges including high (effective) taxes on corporate income, tax incentives and tax exemptions. A survey by Price Waterhouse Coopers undertaken in developing the World Bank's annual "Doing Business Survey" found that a typical firm in sub-Saharan Africa pays the equivalent of 71% of its profits in taxes, which is 15% higher than the second-highest rate, paid in Europe and Central Asia.[9] In a small number of countries, the amount of taxes paid by firms is much higher than their net profits (see Figure 7).

[9] Among the most prominent examples of such other business taxes are employment taxes (levied on the employee), and indirect (or consumption) taxes such as value added tax (VAT), goods and services tax (GST) and environmental taxes. Price Waterhouse Coopers (2007).

Figure 7: Total Tax Rate versus Corporate Income Tax



Source: Doing Business 2007, Background paper

24. African countries are also confronted with increasing tax competition on corporate income tax (CIT), as countries compete more aggressively to attract foreign investment. Although statutory CIT rates in the region fell markedly in the 1990s, CIT revenue as a share of GDP has remained broadly unchanged, suggesting that the impact of rate reductions on revenue has been mitigated by other factors. Nevertheless, the trend worldwide is toward lower statutory CIT rates, and rates in sub-Saharan African countries are still relatively high. This implies that these countries remain under pressure to further reduce CIT rates, which in turn means that the tax base should be broadened in order to minimize the impact on tax revenue.

25. Recent analytical work has shown the importance of tax exemptions and evasion and that in some countries larger businesses benefit from tax exemptions to a disproportionate degree and tax evasion is more common among smaller businesses. This creates a situation in which medium-sized firms shoulder a disproportionate tax burden, with possible adverse consequences for private investment and economic growth.

IV. What are the key priorities?

Actions by African countries:

- Boost public revenue by addressing tax evasion and avoidance, broadening the tax base and improving the efficiency of tax administration. Continue efforts to increase domestic resource mobilisation, in particular in countries where the ratio of revenue to GDP remains below 15%.
- Strengthen efforts to improve management of natural resources as well as revenue from these resources.

Actions by Development Partners:

- Provide more technical assistance to African countries to enable them to reform their tax systems and improve the efficiency of tax administration.
- Take more effective international action to tackle harmful tax practices, and tax fraud and evasion, including through improved transparency, better information exchange and more effective control mechanisms to help to increase domestic resources available for development.

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DATA APPENDIX

Annex Table 1: Government Revenue, Excluding Grants (% of GDP)

	Pre-Monterrey 1997-2002	Average 2003-05	2006	2007	2008
SUB-SAHARAN AFRICA					
Oil-exporting countries	23.3	24.2	27.9	25.5	25.7
Oil-exporting countries, excluding Nigeria	26.6	28.1	37.2	37.0	34.6
Angola	42.4	38.4	46.4	45.1	39.4
Cameroon	14.6	16.3	19.3	18.8	19.6
Chad	7.8	8.6	16.9	22.9	20.0
Congo. Rep of	26.9	32.8	44.3	42.7	46.3
Equatorial Guinea	22.6	30.7	40.8	38.3	33.3
Gabon	32.5	30.5	31.7	29.5	29.3
Nigeria	20.9	21.6	21.7	17.2	18.4
Middle-income countries	24.4	25.1	27.4	27.9	27.8
MICs, excluding South Africa	31.3	32.0	35.3	34.1	33.0
Botswana	39.2	38.2	39.9	36.8	35.0
Cape Verde	20.9	22.7	23.6	25.2	23.7
Lesotho	43.1	45.9	58.4	60.7	64.5
Mauritius	19.4	19.9	19.8	19.9	19.2
Namibia	32.1	30.3	33.9	35.5	34.5
Seychelles	42.1	49.1	52.5	49.7	40.8
South Africa	23.5	24.3	26.5	27.2	27.2
Swaziland	26.7	30.9	43.5	40.6	39.6
Low-income countries	13.7	16.1	17.1	17.7	18.1
Benin	15.2	16.6	16.8	20.6	19.3
Burkina Faso	12.1	12.6	13.0	13.6	13.5
Ethiopia	15.1	15.6	14.8	12.8	12.8
Ghana	17.6	22.1	21.9	22.5	23.0
Kenya	20.2	20.8	21.1	22.5	22.4
Madagascar	10.2	10.7	10.7	11.1	12.3
Malawi	17.0	24.1	16.8	20.1	19.0
Mali	13.9	17.2	17.7	17.7	17.2
Mauritania	22.3	28.3	29.4	25.1	26.0
Mozambique	11.1	13.5	15.0	16.0	15.8
Niger	9.7	10.8	13.2	15.5	18.4
Rwanda	11.1	13.1	12.9	11.6	13.8
Senegal	16.5	18.5	19.9	20.9	20.2
Sudan	9.5	19.3	19.5	19.0	19.7
Tanzania	10.0	10.5	11.8	13.1	14.9
Uganda	11.2	11.5	12.5	12.7	13.3
Zambia	18.8	18.0	16.9	19.3	20.3
Fragile countries	13.5	14.5	16.1	16.8	17.2
Including Zimbabwe	15.7	17.2	20.2	24.8	..
Burundi	17.7	20.4	18.9	18.7	18.3
Central African Republic	9.2	8.2	9.5	10.2	10.4
Comoros	12.9	15.8	13.6	12.7	12.4
Congo, Dem. Rep of	5.8	9.5	12.8	14.1	16.7
Côte d'Ivoire	17.7	17.1	18.4	19.6	18.6
Eritrea	28.9	27.3	23.0	22.8	23.5
Gambia, The	17.6	18.7	21.2	21.6	21.1
Guinea	11.3	12.3	14.8	14.3	15.6
Guinea-Bissau	15.0	16.7	19.6	15.6	20.4
Liberia	..	13.2	14.6	18.6	23.8

Sao Tome and Principe	16.7	32.2	21.1	40.2	34.6
Sierra Leone	9.4	12.2	11.8	10.8	11.8
Togo	13.6	16.5	16.9	17.0	16.6
Zimbabwe	24.0	27.4	14.3	6.0	..
Sub-Saharan Africa	21.2	22.6	25.0	24.7	24.3
Excluding Nigeria and South Africa	18.8	21.0	25.0	25.4	25.2
Oil-importing Countries	20.3	21.7	23.2	23.6	23.3
Excluding South Africa	16.8	18.3	19.2	19.6	19.5
Resource-intensive countries	23.3	24.1	27.3	25.4	25.4
Oil	23.3	24.2	27.9	25.5	25.7
Non-oil	22.9	23.5	24.5	24.8	23.8
NORTH AFRICA					
Algeria	33.1	38.0	43.0	42.4	44.4
Egypt	27.4	24.8	28.2	27.8	27.1
Libya	40.9	60.3	72.1	74.2	79.9
Morocco	23.0	22.6	25.2	27.9	27.1
Tunisia	24.1	23.7	23.8	24.0	23.3

Note: The figures for Sub-Saharan Africa have been adjusted to take into account Mauritania and Sudan which are classified as MECA countries in IMF reports.

Source: IMF Regional Economic Outlook Series: Sub-Saharan Africa, (October 2008) and Middle East and Central Asia (May 2008).

FOCUS ISSUE 2: OTHER FINANCIAL FLOWS

I. Overview of commitments

Africa:

NEPAD Founding Statement (2001)

- African leaders agreed to encourage and boost private capital flows as an essential component of a sustainable long-term approach to filling the resource gap in Africa.
- African leaders also pledged that they will promote the deepening of financial markets within countries as well as cross-border harmonization and integration.

Monterrey Consensus (2002)

- Governments committed to continue their efforts to achieve a transparent, stable and predictable investment climate, with proper contract enforcement and respect for property rights, embedded in sound macroeconomic policies and institutions that allow businesses, both domestic and international, to operate efficiently and profitably and with maximum development impact.

Development Partners:

Monterrey Consensus (2002)

- To complement national efforts, development partners were encouraged to increase their support for private foreign investment in infrastructure development and other priority areas in developing countries.

G8 Summit Declaration (2007)

- At Heiligendamm, G8 countries committed to implement measures to reduce the transactions costs of remittances and improve access to financial services in Africa. They also committed to providing assistance to enhance capital markets in Africa.

World Summit Outcome (2005)

- Leaders resolved to encourage greater direct investment, including FDI, in developing countries and countries with economies in transition to support their development activities and to enhance the benefits they can derive from such investments.

II. What has been done to deliver on these commitments?

Africa:

- Over the past few years, African countries have increased their efforts to develop or enhance their national policies and laws with a view to improving the investment climate. Ten countries introduced policy measures in 2007, most of which were in the direction of making their regulatory frameworks more favourable to FDI. In 2007, 11 African countries signed a total of 11 bilateral investment treaties (BITs), and 10 countries signed 11 double taxation treaties (DTTs), raising the total number to 696 and 459 respectively.

- To increase FDI inflows, 40 African countries introduced 57 new measures affecting FDI in 2006, of which 49 encouraged inward FDI (UNCTAD's annual survey on changes to national laws and regulations in 2006).
- Of these investment promotion measures, 14 were related to sectoral liberalization, more specifically: (i) allowed partial or full foreign ownership of their telecommunications industries in Botswana, Burkina Faso, Burundi, Cape Verde, Ghana, Kenya and Namibia; (ii) open up banking industries wholly or partially in Congo, Egypt and Nigeria; (iii) open up legal services and insurance industry in Mauritius and Swaziland respectively; (iv) corporate income tax reductions (in Algeria, Egypt, Ghana, Lesotho, Mozambique, Tunisia, Uganda and the United Republic of Tanzania).
- Other major measures included the establishment of specialized investment zones or parks (in Botswana, Eritrea, Morocco, the United Republic of Tanzania and Zambia), or the setting up of advisory councils for investment promotion (Ethiopia).
- African regional entities also introduced a number of FDI-related policy and institutional reforms in 2007.
- *The Common Market for Eastern and Southern Africa (COMESA)* adopted a regional investment agreement which will, by 2010, grant all investors in COMESA national treatment, most-favoured-nation treatment and protection against expropriation and taxation measures that could amount to an expropriation. The COMESA Common Investment Area Committee has been created with a mandate to supervise the Agreement.
- *The Economic Community of West African States (ECOWAS)* created a department responsible for promoting cross-border investments and joint venture businesses and is preparing a community investment code aimed at harmonizing and simplifying investment policies within the region.
- *The Southern African Development Community (SADC)* is undertaking a joint investment promotion programme with the EU.

Development Partners:

- Several donors have taken measures to strengthen financial markets and boost private capital flows in the region. The African Financial Sector Initiative of the United States and the G8 proposal to develop a Regional Micro- Small- and Medium-size Enterprise Investment Fund (REGMIFA) are representative initiatives in this area.
- G8 countries are also stepping up efforts to enhance local bond market development in African countries. At the G8 Finance Ministers meeting in Osaka, Japan in June 2008, Ministers reiterated their commitment to boost the development of local bond markets and indicated that they are increasing contributions for the development of infrastructure in Africa.
- To reduce the cost of remittance transfers, several EU countries have set up websites that provide information to migrants on prices charged by various firms.
- Various countries and international and regional organizations have launched a number of initiatives to promote investment in Africa. *Japan*, at the Fourth Tokyo International Conference on African Development (TICAD IV) in May 2008, announced its decision to create a facility within the Japan Bank for International Cooperation (JBIC) for investment in Africa of US$2.5 billion over the next five years. This is twice the amount of total FDI flows from Japan to Africa during the past five years (2003–2007) or twice the size of Japanese FDI stock in Africa in 2007.
- *The United States* signed trade and investment framework agreements with three African countries (Mauritius and Rwanda in 2006, and Liberia in 2007). It also negotiated a Trade, Investment and Development Cooperation Agreement with the Southern African Customs Union (SACU).
- *China* expanded its support to Chinese investments in Africa, building on its general investment policy to Africa adopted in 2006. In 2007, the Export-Import Bank of China financed over 300 projects in Africa.
- *The European Free Trade Area (EFTA)* started implementing a free trade agreement (FTA) with Egypt in 2007. The Agreement includes provisions on investment, services, state monopolies and subsidies,

protection of intellectual property, capital movements, government procurement and institutional and procedural matters. In May 2008 an FTA between the EFTA States and SACU also entered into force.

- *The Organisation for Economic Cooperation and Development (OECD)* has developed various initiatives involving the promotion of private and international investment in Africa. The NEPAD-OECD Africa Investment Initiative aims to improve the capacity of African countries to strengthen the investment environment for growth and development, taking advantage of OECD's peer learning method and investment policy approaches such as the Policy Framework for Investment (PFI), the most comprehensive multilaterally-backed investment policy instrument.

III. What are the results?

1. Net private capital flows to Africa were up sharply in 2007 by US$30 billion to reach US$81 billion, the highest level on record. The rise was mostly due to a surge in FDI (US$9 billion) and private debt flows (US$21 billion). The increase was more significant in sub-Saharan Africa (Table 1). Meanwhile, net portfolio equity inflows to the region dropped by US$8 billion, with South Africa accounting for much of the decline. For South Africa, the marked decline in portfolio equity inflows likely reflects the confluence of two factors: increased risk aversion by foreign investors following the global credit turmoil; and reduced holdings of South African equities by non-resident portfolio investors. After several years of net reflows that began in the late 1990s, Africa now enjoys renewed access to commercial bank lending. Private debt flows to Africa kept pace with the upswing in overall flows to developing countries, reaching almost US$19 billion in 2007, driven by abundant global liquidity and steady improvements in credit quality of several African countries

Table 1: Net Private Capital Flows to Africa
(US$ billion)

	2002	2003	2004	2005	2006	2007e
FDI flows	13.1	18.0	16.0	26.0	36.4	45.2
North Africa	*2.6*	*3.6*	*3.5*	*10.0*	*19.7*	*20.0*
Sub-Saharan Africa excl. S. Africa	*9.8*	*13.6*	*11.8*	*10.8*	*17.2*	*19.6*
South Africa	*0.7*	*0.8*	*0.7*	*6.6*	*-0.5*	*5.6*
Portfolio equity flows	-0.7	0.7	7.3	8.2	15.4	8.9
North Africa	*0.3*	*0.2*	*0.3*	*1.8*	*1.7*	*1.7*
Sub-Saharan Africa excl. S. Africa	*0.0*	*0.0*	*0.0*	*0.0*	*0.1*	*0.2*
South Africa	*-0.4*	*0.7*	*6.7*	*7.4*	*15.0*	*7.0*
Commercial bank debt flows	-2.4	0.0	1.8	5.0	-2.4	18.6
North Africa	*-0.5*	*-1.2*	*-0.6*	*1.2*	*-0.9*	*3.5*
Sub-Saharan Africa excl. S. Africa	*-0.4*	*2.0*	*2.1*	*4.0*	*-1.2*	*12.1*
South Africa	*-1.5*	*-0.8*	*0.3*	*-0.2*	*-0.3*	*3.0*
Bonds flows	6.5	1.1	3.9	3.6	0.7	8.3
North Africa	*5.0*	*0.7*	*3.3*	*2.3*	*0.6*	*2.5*
Sub-Saharan Africa excl. S. Africa	*2.0*	*1.2*	*1.0*	*1.3*	*0.4*	*5.8*
South Africa	*-0.5*	*-0.8*	*-0.4*	*0.0*	*-0.3*	*0.0*
Total private capital flows	17.1	20.0	28.7	45.2	51.5	81.0
North Africa	*7.4*	*3.3*	*6.5*	*15.3*	*21.1*	*27.7*
Sub-Saharan Africa excl. S. Africa	*11.4*	*16.8*	*14.9*	*16.1*	*16.5*	*37.7*
South Africa	*-1.7*	*-0.1*	*7.3*	*13.8*	*13.9*	*15.6*
Memo Items						
South Africa FDI Inflows	*0.7*	*0.7*	*0.8*	*6.6*	*-0.5*	*5.6*
South Africa FDI Outflows	*0.0*	*0.0*	*1.4*	*0.9*	*6.7*	*3.7*

Sources: World Bank, Global Development Finance (2008).

2. While net bond flows rose by a smaller amount than other private flows (US$7.6 billion), developments in 2007, which saw the expansion of African sovereign as well as corporate access to the international bond market, are noteworthy. Ghana became the first heavily indebted poor country (HIPC) to issue an external bond, with a US$750 million Eurobond issue in September 2007. The bond issue was oversubscribed several times, despite being launched as international financial markets became more unsettled[10]. Gabon issued its inaugural sovereign bond in December 2007 when it launched a US$1 billion 10-year Eurobond with a yield of 8.25% that was used to prepay its Paris Club creditors. A private Nigerian bank and a public bank successfully issued Eurobonds in 2007 before the country's first sovereign bond issue, which is expected to be launched in 2008[11]. The relatively low spreads on bond issues by African governments or corporations reflect the favourable perception of the above countries in international markets.[12] As shown in Table 2, Africa bond flows in 2007 compare favourably with other developing regions.

Table 2: Private bond Flows to Developing Regions by Region (2002-2007)

(US$ billion)

	2002	2003	2004	2005	2006	2007
All Developing Countries	8.8	19.6	41.1	52.6	25.3	79.3
East Asia and Pacific	0.1	1.8	9.7	7.8	5.5	6.5
Europe and Central Asia	3.6	8.9	23.6	28.2	33.9	52.0
Latin America and the Caribbean	-0.8	11.0	-0.3	16.0	-19.0	8.1
Middle East and North Africa	5.0	0.7	3.3	2.3	0.6	2.7
South Asia	-0.7	-3.1	4.1	-2.9	4.3	4.2
Sub-Saharan Africa	1.5	0.4	0.6	1.3	0.1	5.8

Source: World Bank Debtor Reporting System and staff estimates

3. Portfolio investments have been dominated by South Africa. In recent years 85 percent of South Africa's current account deficit was financed by portfolio investments, but that plummeted to 38 percent during the final quarter of 2007. Given South Africa's significant current account deficit, the unwillingness to continue providing short-term flows could put pressure on the rand. But developing countries' easy access to global capital markets deteriorated in late 2007 and into 2008 in the wake of the U.S. subprime mortgage crisis. Besides reducing capital flows to developing countries, the turmoil has increased borrowing costs, although less so than in previous episodes, when emerging markets themselves were the primary source of difficulty.

4. As mentioned earlier, FDI and portfolio investment together grew to US$53 billion in 2007 – a new record. Despite higher inflows, Africa's share in global FDI remained at about 3%. The inflows were supported by a continuing boom in global commodity markets and by improved policy environments. A large proportion of the FDI projects launched in the region in 2007 were linked to the extraction of natural resources. The US and Europe were the main investors in the region, followed by African investors,

[10]. The strong reception of Ghana's bond issue helps to dispel an earlier concern that access to HIPC debt relief may make it more difficult for HIPC countries to access capital markets in the future.

[11] This pattern goes against the conventional wisdom that countries must first issue sovereign bonds to set a benchmark to price subsequent corporate issues.

[12] According to the ratings by Standard and Poor's and by Fitch, Nigeria is rated BB- and Ghana, B+. These ratings rank these two countries at the level of Turkey for instance. Gabon is not rated but is believed to have a slightly better rating than Nigeria. Currently 20 sub-Saharan countries are rated. The growing use of sovereign credit ratings in Africa reflects the improving perception by international private banks of Africa's potential and gives added confidence to investors.

particularly from South Africa. Asian investors concentrated mainly on oil and gas extraction and infrastructure.

5. The growth of FDI inflows was spread across 35 countries (see Figure 1), and included many natural resource producers that have been attracting flows in the past few years, as well as new host countries. As a result, for almost half of Africa, FDI flows contributed more than 20 percent of fixed investments (see Table 3). The distribution of the inflows changed slightly. While most countries of North Africa continued to attract inward FDI, large inflows to Nigeria and South Africa, combined with good performance in Equatorial Guinea, Madagascar and Zambia – each receiving about US$1 billion or more inflows in 2007 – boosted overall FDI to sub-Saharan Africa. The value of cross-border mergers and acquisitions (M&As) in the region fell in 2007 due partly to the smaller number of mines and exploration projects available for sale. Because of reduced investments in new mines, the number of investment projects in the region also declined to 380 in 2007, from 473 in 2006. South Africa, Egypt and Morocco are also major investors in Africa.

Figure 1: Distribution of FDI Flows by Range, 2007

Range	Inflows	Outflows
Over $3.0 bn	Nigeria, Egypt and South Africa	South Africa
$2.0 bn to $2.9 bn	Morocco, Libyan Arab Jamahiriya and Sudan	..
$1.0 bn to $1.9 bn	Equatorial Guinea, Algeria and Tunisia	..
$0.5 bn to $0.9 bn	Madagascar, Zambia, Ghana, Kenya, Democratic Republic of Congo, Namibia, United Republic of Tanzania, Chad and Burkina Faso	Egypt and Morocco
$0.2 bn to $0.4 bn	Botswana, Mozambique, Côte d' Ivoire, Uganda, Mali, Congo, Mauritius, Cameroon, Gabon, Ethiopia and Seychelles	Liberia, Angola, Algeria and Nigeria
Less than $0.2 bn	Djibouti, Cape Verde, Mauritania, Somalia, Guinea, Lesotho, Sierra Leone, Senegal, Togo, Zimbabwe, Rwanda, Gambia, Malawi, Benin, Liberia, Swaziland, São Tomé and Principe, Central African Republic, Niger, Guinea-Bissau, Comoros, Burundi, Eritrea and Angola	Mauritius, Gabon, Botswana, Kenya, Tunisia, Rwanda, Sudan, Senegal, Seychelles, United Republic of Tanzania, Mauritania, Congo, São Tomé and Principe, Zimbabwe, Swaziland, Malawi, Mali, Niger, Cape Verde, Mozambique, Côte d'Ivoire, Benin, Cameroon and Burkina Faso

Source: UNCTAD, World Investment Report, 2008

Table 3: FDI inflows as Share of Investment in Selected Non-Oil/Commodity Producing Countries, 2006

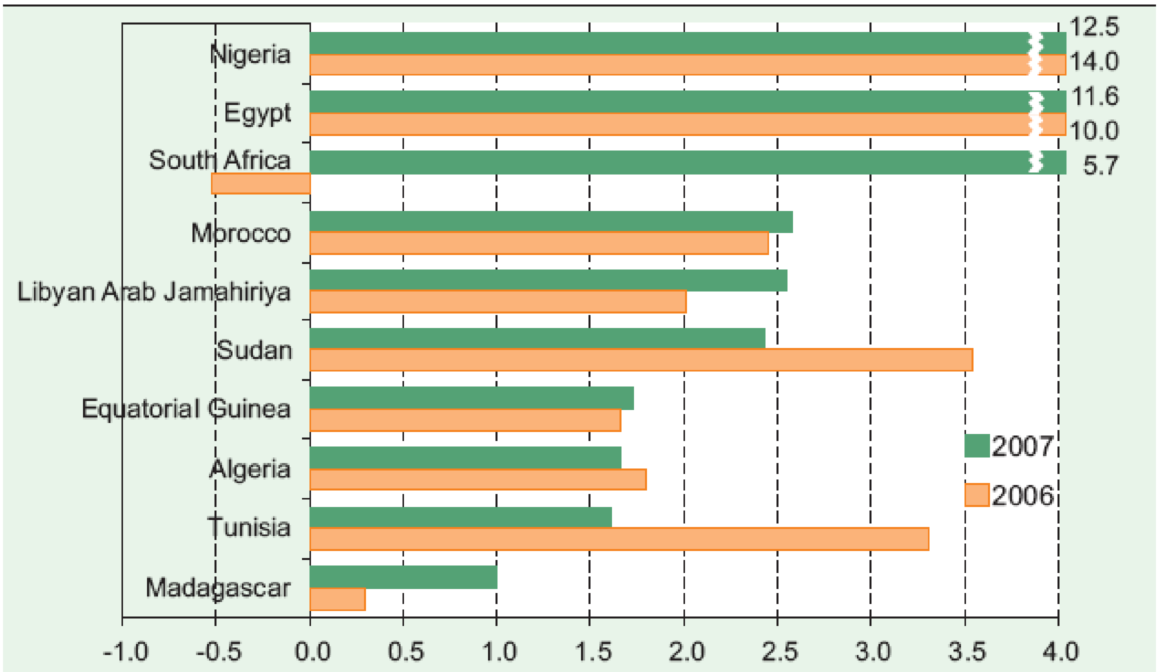
Country	FDI Inflows in 2007 (US$ million)	2005	2006 (percent)	2007
Burkina Faso	600	3	2	37
Cape Verde	177	21	30	34
Central African Republic	27	21	22	29
Egypt	11,578	32	50	43
The Gambia	64	37	58	40
Madagascar	997	8	25	61
Malawi	55	14	15	26
Mozambique	427	9	9	23
Namibia	697	22	24	40
Seychelles	248	81	132	248
Sierra Leone	81	104	69	81
Tanzania	600	20	18	18
Tunisia	1618	12	46	20

*S*ource: UNCTAD (2008)

6. In *North Africa*, renewed privatization programmes and policies aimed at improving efficiency contributed to maintaining large FDI inflows to North Africa in 2007. Inflows to Egypt remained very large, reaching nearly US$12 billion in 2007, a 15% increase from 2006. The major industries that attracted FDI to that country included textiles, oil and chemicals, and generic pharmaceutical production. Privatization of several state-owned enterprises also played a role in the sub-region. In *West Africa*, the primary sector and privatization schemes of telecommunications companies led to another year of large inflows (US$15.6 billion). FDI mostly reflected expansion projects in Nigeria’s oil industry, and upgrades of projects already operating in Burkina Faso, Côte d’Ivoire and Mali. *Eastern and Central Africa* each received about US$4 billion of FDI each. There were significantly higher inflows to Kenya (telecoms and railways), Madagascar (nickel exploitation) and Mauritius (tourism). In Central Africa, much of those inflows went into the primary and services sectors, including infrastructure development, with a large part of the increase reflecting greater spending on oil and mining exploration. FDI inflows to *Southern Africa* grew more than fivefold, the highest among the sub-regions, to US$7 billion in 2007. A major increase in FDI to the top five host countries – South Africa, Zambia, Namibia, Botswana and Mozambique – accounted for this impressive growth.

7. Cross-border M&As in the extraction industries and related services continued to be a significant source of FDI, in addition to new inbound M&A deals in the banking industry. Nigeria, Egypt, South Africa and Morocco were the largest recipients (see Figure 2). Together with foreign investors, leading African firms (such as Eskom, MTN, Vodacom, Spoornet and Transnet of South Africa) played an important role in infrastructure projects (electricity, telecommunications and water), illustrating a trend towards greater diversification of inflows in some countries, away from traditional sectors (e.g. oil, gas and other primary commodities).

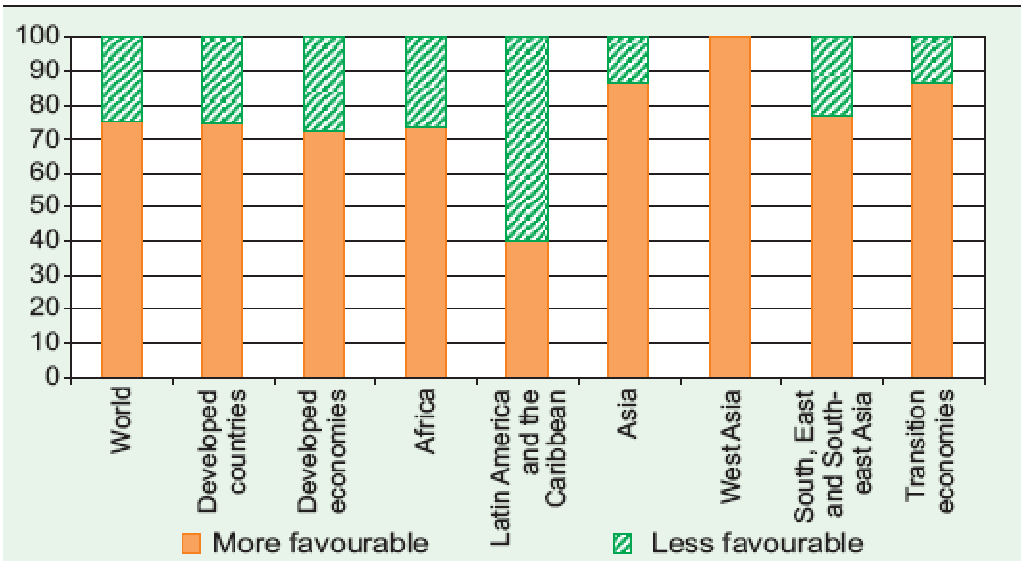
Figure 2: Africa: Top 10 Recipients of FDI Inflows, 2006–2007 (US$ billion)



Source: UNCTAD (2008)

8. The 10 leading FDI host countries accounted for over 80% of the region's FDI inflows. Nine countries received FDI inflows of US$1 billion or more. South Africa and Madagascar rejoined the list of top 10 FDI host countries, displacing Chad and Ghana from the 2006 list, though inflows remained large in those two countries in 2007. Compared to other developing regions, Africa's changes in regulatory frameworks compared well with other developing regions (Figure 3). The top 10 host countries in 2007 shared a number of common features: large reserves of natural resources and/or active privatization programmes, liberalized FDI policies and active investment promotion activities.

Figure 3: Regulatory Changes, by Nature and Region, 2007 (%)

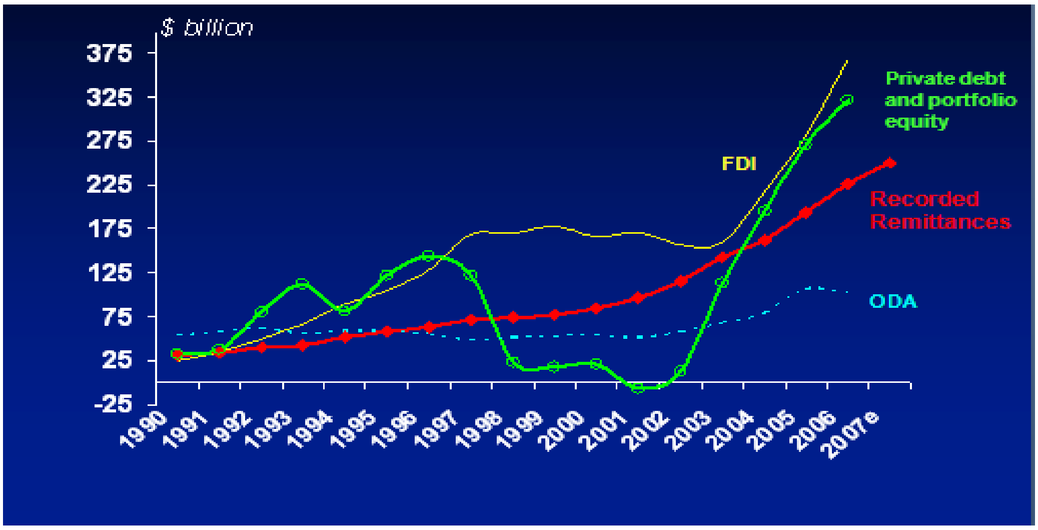


Source: UNCTAD database on national laws and regulations

Workers' Remittances

9. Over the past decade, remittances have become increasingly prominent. Remittance flows to developing countries are estimated to have reached US$265 billion in 2007. This amount, however, reflects only transfers through official channels. The true size of remittances received by developing countries is believed to be in excess of US$300 billion. Compared to ODA and other financial flows, remittances are the largest source of external financing in many developing countries (Figure 4).

Figure 4: Remittance Flows in Developing Countries (US$ billion)



Source: Adapted from Dilip Ratha's presentation

10. Workers' remittances are becoming important sources of development finance in both sub-Saharan and North Africa. Table 4 shows that between 2000 and 2007, recorded remittances from sub-Saharan Africa more than quadrupled to reach US$19 billion. The increase is similarly rapid in North Africa, reaching also US$19 billion. Four of the largest remittance recipient countries in Africa are in North Africa. It should be noted that a large proportion of flows to SSA is unrecorded. Recent estimates suggest that 73% of remittances flow to SSA were through unofficial channels. One of the factors militating against enhanced remittance flows to SSA is the high cost of transfers. For instance, the average cost of sending US$200 from London to Nigeria is about 14% of the amount sent. In addition, the average cost of sending the same amount from Benin to Nigeria is as high as 17%.[13]

Table 4: Remittances in Africa – Ten Largest Recipients and Sub-totals (US$ billion)

	2000	2001	2002	2003	2004	2005	2006	2007
Nigeria	1.4	1.2	1.2	1.1	2.3	3.3	5.4	9.2
Egypt	2.9	2.9	2.9	3.0	3.3	5.0	5.3	7.7
Morocco	2.2	3.3	2.9	3.6	4.2	4.6	5.5	6.7
Algeria	0.8	0.7	1.1	1.8	2.5	2.0	2.5	2.9
Tunisia	0.8	0.9	1.1	1.3	1.4	1.4	1.5	1.7
Kenya	0.5	0.6	0.4	0.5	0.6	0.8	1.1	1.6
Sudan	0.6	0.7	1.0	1.2	1.4	1.0	1.2	1.2
Uganda	0.3	0.3	0.4	0.3	0.3	0.4	0.8	0.9
South Africa	0.3	0.3	0.3	0.4	0.5	0.7	0.7	0.7
Senegal	0.2	0.3	0.3	0.5	0.6	0.6	0.6	0.9
Lesotho	0.3	0.2	0.2	0.3	0.4	0.3	0.4	0.4
Sub-Saharan Africa, total	4.6	4.7	5.0	6.0	8.0	9.3	12.4	19.0
North Africa, total	6.6	7.8	7.9	9.6	11.5	13.0	14.8	19.0
Africa	11.2	12.5	12.9	15.6	19.5	22.3	27.2	38.0

Source: World Bank, Migration and Remittances Fact Book, 2008 plus updates.

[13] Ratha, Mohapatra and Plaza (2008).

11. To increase the developmental impact of remittances, there is the need to create domestic conditions that would allow workers to transfer funds, and recipients to deposit funds, through the formal banking system. In this regard, there is the need for African governments and advanced countries to take more measures to reduce the transactions costs of remittances. Strengthening competition in the remittance industry as well as adopting new technologies such as internet and mobile telephony will contribute significantly to achieving this objective. The large and steady flows of remittances can potentially be used to raise significant bond financing by using securitisation of future remittance flows. The African Export-Import Bank (Afreximbank) has been active in facilitating future-flow securitisation. In 1996, it co-arranged the first-ever such arrangement in favour of a development bank in Ghana backed by its Western Union remittance receivables. Securitisation of future remittance flows has the potential to boost resources for development in the region and efforts should be made to explore this option which by some conservative estimates will yield US$2 billion annually to SSA.

12. Diaspora bonds, which work on the same principle, have been issued in a number of large remittance recipients (Philippines, Armenia, Sri Lanka, Pakistan and Bangladesh) and are being considered by Kenya and Ghana. Tapping this source of finance, however, requires building legal infrastructure, enforcing creditor rights, developing partnerships with banks abroad, and financial market development.

IV. What are the key priorities?

Actions by African countries:

- Continue efforts to improve the business environment and to promote public/ private partnerships (PPP).
- Improve capacity to monitor and manage private capital flows.
- Foster regional integration and south-south cooperation.
- Create the conditions (including human capital development) that would foster more diversified FDI to higher value-added activities.

Actions by development partners:

- Support Africa's effort to promote private capital flows and build an enabling domestic business environment.
- Support further infrastructure development, risk alleviation instruments and techniques to facilitate PPP.
- Reduce the transactions costs of remittances and increase their developmental impact through measures that encourage migrants to use the banking system for sending money to their home countries.

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FOCUS ISSUE 3: DEVELOPMENT ASSISTANCE

I. Overview of commitments

Africa:

Paris Declaration on Aid Effectiveness, 2005

- Developing countries made commitments to: exercise effective leadership over their development policies and programs; strengthen national systems and public financial management capacity with support from donors; manage resources and improve decision-making for results; and be mutually accountable for development results.

Accra Agenda for Action, 2008

- Developing countries and donors reaffirmed the Paris Declaration commitments and agreed on concrete and monitorable actions to accelerate progress to meet those commitments by 2010.

Development Partners:

<u>On Aid Volume</u>

Monterrey and Kananaskis G8 (2002)

- The Monterrey Conference on Financing for Development urged developed countries to make concrete efforts towards the ODA/GNI target of 0.7%. Subsequently, the European Union committed to reach an interim target of 0.39 percent and the U.S. to increase its ODA by US$5 billion between 2002 and 2006.[14]

- At Kananaskis in 2002, the G8 reconfirmed ODA commitments made in Monterrey.

Further Commitments Made in 2005

- The EU member countries as a group pledged in May 2005 to reach 0.7% of ODA/GNI by 2015 with an interim collective target of 0.56% in 2010 and individual target of 0.51% for the 15 pre-enlargement member states (EU-15) and 0.17% for new member states by 2010 and at least half of the increase going to Africa.

- At the subsequent G8 meeting in Gleneagles, other G8 member countries made further commitments, which together with contributions by other DAC donors would lead to a doubling of official development assistance to Africa to US$50 billion a year[15] by 2010 compared to the 2004 level.

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[14] Simulations performed by the OECD Development Assistance Committee on the basis of the EU and US and projections of support by other DAC member countries showed an increase of total net ODA from US$57 billion in 2002 to US$74.7 billion in 2006 (at 2002 constant prices). See Annex Table 1 for more detail.

[15] The commitment made at Gleneagles in July 2005 of doubling aid to Africa by 2010 (compared to 2004 level) has led to a number of questions such as whether Africa in the communiqué refers to both sub-Saharan Africa and North Africa and whether the increase in aid volume referred to is expressed in nominal or real terms. Inter-agency discussions led by the OECD/DAC have come to an agreement that Africa includes North Africa and that the US$25 billion figure refers to the increase expressed in 2004 prices and exchange rates. To further add to the confusion, total net ODA in 2005 to Africa (only available in late 2005) was estimated at US$29.2 billion. According to the MDG Africa Steering Group report 'Achieving the MDGs in Africa'; the nominal equivalent in 2007 prices and exchange rates is about US$62 billion.

- In addition to budgeted development assistance, the Gleneagles Communiqué also noted that a group of countries believed that innovative financing mechanisms could provide additional resources to help cover the financing needed to achieve the MDGs.

- Subsequent G8 meetings in St Petersburg (2006), Heiligendamm (2007) and Hokkaido (2008) reaffirmed earlier commitments by G8 countries regarding increasing development assistance to Africa.

<u>On Aid Effectiveness</u>

Monterrey and Kananaskis G8 (2002)

- The Monterrey Consensus (2002) urged multilateral and bilateral financial and development institutions to intensify efforts to harmonize their operational procedures so as to reduce transaction costs; untie aid to the least developed countries, as agreed by OECD/DAC; enhance resource predictability; promote ownership and leadership of development strategies by developing countries; enhance recipient countries' input in technical assistance programmes; and increase the effective use of local technical assistance resources.

- At Kananaskis in 2002, the G8 pledged to improve aid effectiveness, reduce the burden of aid management, and annually review progress towards the MDGs. They reiterated their 2001 commitment to untie aid to the Least Developed Countries.

World Summit Outcome, 2005

- Leaders reaffirmed their commitments in the Monterrey Consensus and urged developed countries to make more concrete efforts to fulfil their commitments on aid quantity and aid quality.

Paris Declaration on Aid Effectiveness, 2005

- Development partners made commitments to: respect partner country leadership over their development policies and programs; base their support on partner countries' national development strategies, institutions, and procedures; harmonize donor actions; focus on results; and provide timely, transparent and comprehensive information on aid flows.

Accra Agenda for Action, 2008

- Donors and developing countries reaffirmed the Paris Declaration commitments and agreed on concrete and monitorable actions to accelerate progress to meet those commitments by 2010.

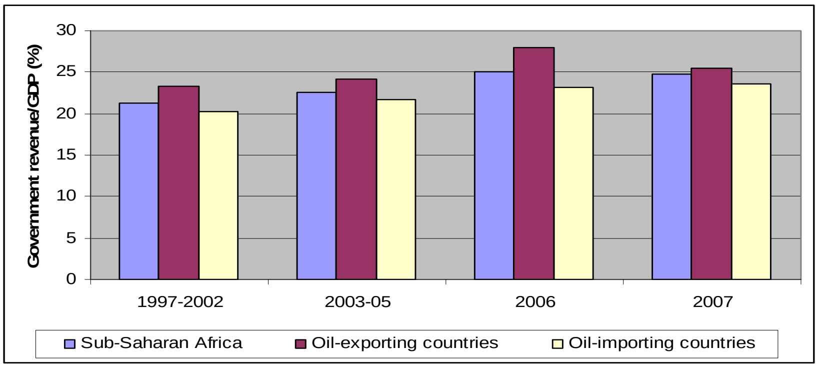
II. What has been done to deliver on these commitments?

Africa:

1. Most governments in the region now have national development strategies, mostly in the form of poverty reduction support strategies (PRSPs) and several have strengthened the ownership and leadership of their development programmes and outcomes. Seventeen countries in sub-Saharan Africa have completed second generation PRSPs, which are substantially stronger and more operational than the first versions. Several countries have completed MDG needs assessments/costings and the results of these efforts are reflected in many PRSPs.

2. Most African countries have intensified efforts to mobilize domestic resources. As shown in Figure 1, the rise in domestic revenue mobilisation is occurring in both oil-exporting and oil-importing countries and as discussed in the Domestic Revenue Mobilisation section of this report. Africa has increased its domestic public revenue by the equivalent of US$ 367 billion in 2007 or several times the size of foreign aid.

Figure 1: Government Revenue as a Share of GDP (%)



Source: IMF Regional Economic Outlook: Sub-Saharan Africa, various issues

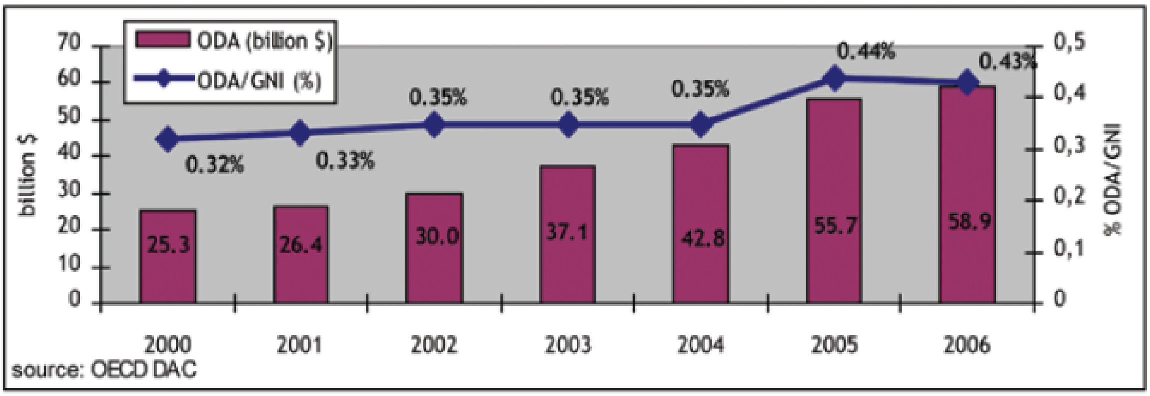
3. Africa has also begun to take leadership of the public financial management process and is increasingly broadening local stakeholder participation in the aid management and development process thereby increasing accountability to domestic constituents. Nevertheless, consultations tend to be ad-hoc -- and therefore mechanisms need to be put in place for broader and more systematic engagement of all stakeholders.

4. The Africa Peer Review Mechanism (APRM) launched by the New Partnership for Africa's Development (NEPAD), the African Union Convention on Corruption, and the Extractive Industries Transparency Initiative (EITI) have had significant success in improving governance. African governments are increasing their revenue base and using more of these resources to meet the costs of economic development. In addition, civil society is playing an important role in holding governments to account in many countries. But there is still much work to be done.

Development Partners:

5. Since the Monterrey Consensus was adopted in 2002, development partners have made efforts to mobilize *support for increasing aid flows* to Africa. The increasing attention given to Africa in G8 Summits as well as other international events attests to this fact. Among the large groupings of donors, the European Union (EU) and United States have either delivered their ODA commitments for 2006 or set up new frameworks toward that end. As shown in Figure 2, as a group, the EU provided net ODA disbursements equivalent to 0.43% of its combined GDP in 2006 against a target of 0.39% announced at Monterrey.

Figure 2: EU-15 ODA disbursements (US$ billion and % ODA/GNI)



Source: Adapted from AWEPA (2007).

6. The development commitments made since Monterrey in 2002 were reaffirmed in December 2005 with the adoption of the *EU Strategy for Africa* by the European Council, which proposes a strategic partnership for security and development between the European Union and Africa. The Strategy aims to improve the coordination, coherence and consistency of the EU's policies and instruments supporting Africa with those of its Member States. A Joint EU-Africa Strategy was adopted at the second EU-Africa Summit in Lisbon in December 2007. The Paris Declaration and European Council commitments were reaffirmed again in December 2005, when the *European Consensus on Development* was signed.

7. Together with the pledge to increase its development assistance by 50% between the time of the Monterrey Consensus (2002) and 2006, the US created the *Millennium Challenge Account*, which represents a new compact for development with accountability for both rich and poor countries by which recipient countries are selected on a competitive basis through a set of 16 indicators designed to measure a country's effectiveness at ruling justly, investing in people, and fostering private sector development. There are currently 13 African countries among the 25 countries eligible to apply for compact funds under the Millennium Challenge Account.

8. In the area of aid quality and effectiveness, there are ongoing efforts by DAC donors to reduce the transactions costs of aid delivery and management. In particular, DAC countries have made good progress in reducing or eliminating the *use of tied financial aid* to the least developed countries. Furthermore, in May 2008 DAC donors made a decision to extend the coverage of the 2001 OECD recommendation on aid untying to eight non-LDC Heavily Indebted Poor Countries (HIPC). The fact that technical cooperation and food aid are not covered raises concerns about the true impact of these developments.

9. Recently, the EU adopted an MDG-based contract system for aid delivery that would significantly *increase aid predictability* and make medium- to long- term fiscal planning easier in recipient countries. The proposed new approach is expected to provide more long-term and predictable general budget support whenever deemed possible during the implementation of the 10th European Development Fund to focus on MDG-related results, notably but not exclusively in health and education.

10. As part of monitoring the delivery of scaling up promises and their allocations, the DAC conducted its first full annual Survey on Aid Allocation Policies and Indicative Forward Spending Plans in late 2007 and early 2008. The Survey provides a global perspective of future aid flows, which will help to identify resource gaps and opportunities for scaling up in individual partner countries. To meet the requirement of additional finance for development, the increase in aid will mainly have to be in the form of country programmable aid[16], as debt relief is expected to decline over the next few years.

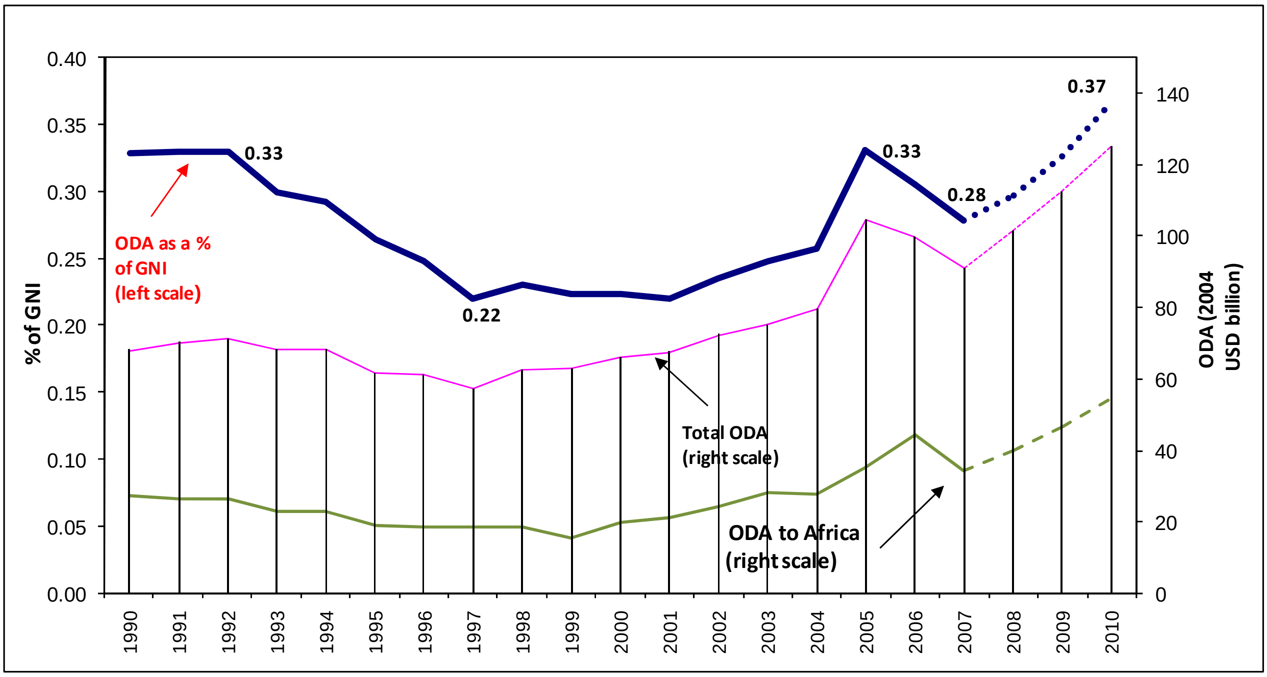
11. To facilitate the *division of labour* as a way to increase aid effectiveness, the EU has recently adopted a voluntary Code of Conduct on Complementarity and Division of Labour in Development Policy. In practical terms, the code of conduct encourages donors to concentrate in a limited number of sectors in a country based on the donor's comparative advantage and enhances donor coordination by supporting a lead donor arrangement in each priority sector.

[16] Country programmable aid reflects the amount of aid that can be programmed at partner country level and is defined through excluding (by subtracting from total gross ODA) aid that is unpredictable by nature (humanitarian aid and debt relief); entails no cross-border flows (administrative costs, imputed student costs, promotion of development awareness, and research and refugees in donor countries); does not form part of co operation agreements between governments (food aid and aid from local governments); is not country programmable by the donor (core funding of NGOs); or is not susceptible for programming at country level (contributions to PPPs).

III. What are the results?

12. While most of the current concern about the **delivery of development aid** is about whether DAC donors will be able to double net ODA to Africa as committed by the G8 at Gleneagles and reaffirmed in Hokkaido last July, the sharp increase in aid volume since the early years of this decade has made it possible for donors to fulfil the commitment they made in Monterrey in 2002. Based on commitments made by the EU, the US and other donors at Monterrey, the OECD-DAC simulations show that net ODA by DAC member countries will increase from US$57 billion in 2002 to US$77.7 billion in 2006 at 2002 prices (see detail in Annex Table 1). As shown in Figure 3, ODA has rebounded sharply in the last few years to reach a peak of US$107.1 billion in 2005. With the sharp decline in debt relief, total ODA in nominal terms has marginally declined in 2006-2007.

Figure 3: DAC Members' Net ODA, 1990-2006



Source: OECD/DAC

13. In 2007, net ODA to Africa amounted to US$ 38.7 billion, representing 37% of total aid. This corresponds to a fall of 18% in real terms, mostly due to exceptional debt relief especially for Nigeria in 2006. If debt relief grants are excluded, then ODA to Africa rose by 12% in real terms. Net ODA to sub-Saharan Africa was US$ 34.2 billion. Compared to 2002, ODA without debt relief almost doubled in 2007. Compared to 2006, total ODA (excluding debt relief) shows a healthy increase of almost 25%, although a significant share of the increase is accounted for by the weakening of the US dollar relative to the Euro and other currencies. Given that debt relief and humanitarian aid are likely to fall back to their historical averages in the next few years, other components of ODA -- especially core development programs -- will have to increase at a rate similar to the increase in 2007 for the G8 and other donors to fulfil their 2010 pledges. Table 1 also shows that a larger share of total ODA was directed to Africa -- with a small decline in 2007 -- although the actual share of Africa in total ODA is still noticeably lower than the announced figure of 50%.

Table 1: ODA to Africa (*US$ billion in nominal terms or percent)*

	2000	2001	2002	2003	2004	2005	2006	2007
				US$ billion				
South of Sahara	12.7	14.0	18.9	24.5	26.0	32.2[c]	40.0[c]	34.2
North of Sahara	2.2	2.4	2.3	2.2	3.0	2.6	2.7	3.2
Africa, unallocated[a/]	0.7	0.4	0.5	0.4	0.5	0.7	0.8	1.3
Total Africa	15.6	16.8	21.7	27.1	29.5	35.5	43.5	38.7
Debt relief	1.1	1.5	3.2	6.7	4.4	8.9	15.2	3.7
Total ODA minus debt relief	14.5	15.2	18.5	20.4	25.2	26.6	28.3	35.0
				Percentage				
Share of Africa (%)	31.2	32.3	35.8	38.4	37.4	33.0	41.2	36.9
				For reference: US$ billion				
Total ODA (US$ billion)	53.7	52.4	58.3	69.1	79.4	107.1	104.4	103.5
ODA/GNI[17] ratio (%)	0.22	0.22	0.23	0.25	0.26	0.33	0.31	0.28

Notes: a/ These figures include amounts that were unspecified in the OECD-DAC database. b/ The outturn in 2003 was heavily determined by the US$4.5 billion of debt relief to the Democratic Republic of Congo under the HIPC initiative. c/ Of which US$14.9 billion for Nigeria's debt relief for the two years (US$5.5 billion in 2005 and US$9.4 billion in 2006).

Source: "Geographical Distribution of Financial Flows by Aid Recipients, 2001-2005", OECD 2007 and preliminary estimates for 2007 figures by OECD/DAC.

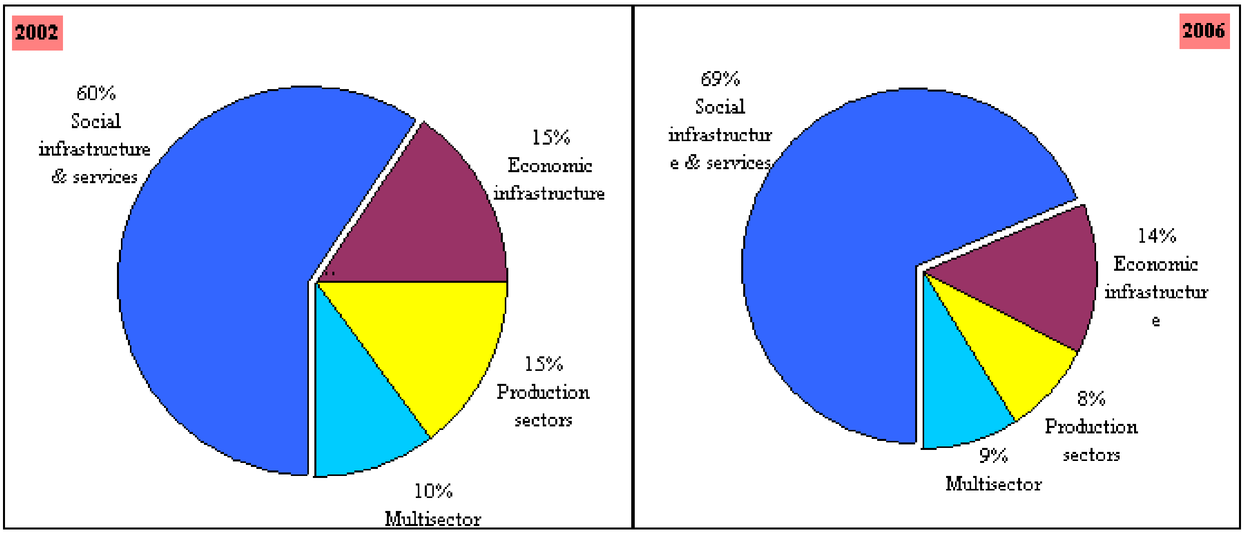
14. Although ODA is rising in nominal terms, OECD figures for 2007 show that the ODA/GNI ratio for the OECD/DAC countries declined from 0.33% in 2005 to 0.28% in 2007. Eleven of the fifteen EU members that committed to reach an ODA/GNI ratio of at least 0.3% in 2006 succeeded in doing so. Other EU countries were also generally on track to meet their commitments.[18] Furthermore, the 2008 report of the MDG Africa Steering Group indicates that significant aid scaling up will be needed in 2008 and 2009 for several key DAC donors if they are to meet the commitments made in Gleneagles.[19] In particular, the 2008 report of the MDG Gap Task Force (set up by the UN Secretary General to monitor commitments under goal 8 of the MDGs) suggests that between 2008 and 2010, net ODA to Africa would have to increase by US$7.3 billion per year (at July 2008 exchange rates) to increase the likelihood of meeting existing commitments on aid volume.

15. In terms of sectoral allocations, there has been a continuous shift over the years in total ODA allocation toward the social sectors and away from productive activities. In the case of sub-Saharan Africa, Figure 4 shows that the share of the social sectors continued to rise, reaching 69 percent of total ODA in 2006, while the share of infrastructure fell from 29% in the first half of the 1990s to 19% in the 2000-2004 period. This situation is likely to change significantly in the near future in light of the strong commitments made by a group of key donors assembled under the aegis of the

[17] Gross national income.
[18] The combined ODA of the 15 DAC-EU members rose by 2.7% to US$59 billion, equivalent to 0.43% of their combined GNI, surpassing the EU collective ODA/GNI target of 0.39%. Net aid disbursements by the U.S., Japan and Canada fell in 2006 mostly due to lower debt relief and also to exceptionally large humanitarian relief for the Indian Ocean tsunami.
[19] See Annex Table 2 for more detail on ODA delivery by G8 member countries and the remaining gaps to meet the targets set in 2005.

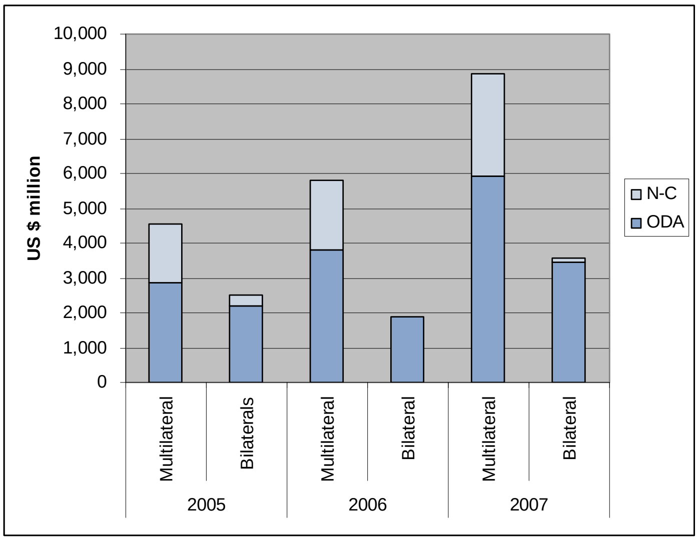
Infrastructure Consortium for Africa (ICA): the ICA indicates that ODA commitments[20] by bilateral and multilateral donors for the infrastructure sector have doubled in the last two years to reach US$9.5 billion in 2007 (see Figure 5).

Figure 4: Distribution of ODA Disbursement to Africa 2002 & 2006



Source: OECDStat, CRS online

Figure 5: ICA commitments to infrastructure projects in Africa 2005 – 2007 (US$ million)



Note: N-C stands for non concessional resources.

Source: ICA Annual Report 2008.

16. New actors such as non-DAC bilateral donors, private entities and vertical funds have also increased the resources for development in Africa and developing countries in general. For example, China and India are playing an important role in financing development in the region, particularly in the energy and infrastructure sectors. Innovative financing approaches such as UNITAID (financed

[20] Note that the figures in Figure 4 represent commitments that will be disbursed over time.

through an airline ticket solidarity tax), Advanced Market Commitments (AMCs) and the international finance facility for immunization (IFF_{Im}) have also generated new finance for development. For example, US$320 million was spent under the UNITAID programme in 2007 and expected revenue for 2008 is about US$390 million. Furthermore, in February 2007, several donors made commitments totalling US$1.5 billion for the development of vaccines for pneumococcal disease under an AMC pilot project.

17. Non-OECD members have long played an important role in Africa's development co-operation, but only limited information is available in this regard. Arab states and funds have traditionally been important actors in Africa. European Union members who are not members of the OECD are increasing their development aid budgets substantially. They have committed to reach ODA targets of 0.17% of GNI by 2010 and 0.33% by 2015. Estonia, Latvia, Lithuania, and Slovenia began to report their net ODA to the DAC in 2006. Other donors that have reported net ODA to the DAC in 2006 are Israel, Thailand and Chinese Taipei. China provides development co-operation on a global scale, and the co-operation programme in Africa has attracted particular attention. The "Beijing Action Plan", agreed in November 2006, includes a broad range of commitments, including a doubling of aid from China to Africa from 2006 to 2009. China has also forgiven debt to HIPC and LDC countries, which amounted to a total of US$ 1.3 billion by end-2006, while the government announced further debt forgiveness to HIPCs and LDCs. Russia and India are additional major players on the development aid scene in Africa. The DAC, jointly with other partners, is working to provide a more complete picture of global aid flows.

18. The nature of private "philanthropy" is changing, and the presence of new actors in the landscape is introducing questions about what constitutes "philanthropy" and how to increase its impact and sustainability. Trends suggest that the field is very dynamic and growing, composed of a vast array of different organizations and approaches. Most important among these new players are large foundations[21] (e.g. Gates Foundation) that are increasing their power and influence in shaping approaches to global public goods and financing for development. Insulated from the factors determining the aid policies and priorities of major donors and partner countries, mega-foundations can contribute levels of funding greater than some donor countries. Operationally, they are increasingly engaged with the larger development community and at times follow harmonized approaches. Other private sector participants are venture philanthropists who take a more problem-solving approach to development problems while also developing viable organizations or businesses. Large international intermediaries (NGOs) are shifting their approach to become more strategic conduits (brokers) of funding to developing countries.

19. On **aid effectiveness**, the Paris Declaration on Aid Effectiveness, endorsed in March 2005, is now recognised as a landmark international agreement aimed at improving the quality of aid and its impact on development. It lays out a road-map of practical commitments, organised around five key principles of effective aid, namely: a) ownership by countries; b) alignment with countries' strategies, systems and procedures; c) harmonisation of donors' actions; d) managing for results; and e) mutual accountability. Each has a set of indicators of achievement. The Declaration also has built-in provisions for the regular monitoring and independent evaluation of how the commitments are being carried out. Compared with previous joint statements on aid harmonisation and alignment, it provides a practical, action-oriented roadmap with specific targets to be met by 2010. Box 1 provides information on recent developments regarding the international aid effectiveness agenda and progress in implementing Paris Declaration commitments. The number of countries and international organizations participating in the High Level Forum and putting their signature to the joint commitments contained in the Declaration was unprecedented and reflected a progressive widening of the range of voices in the aid effectiveness debate.

[21] The United States is home to the majority of foundations, but Europe and Japan also have a number of foundations with increasing interest.

Box 1: Progress in Implementing Paris Declaration Commitments

Background

The multi-donor aid system has been the focus of an expanding international policy discussion in recent years. Agreements reached in the course of three international meetings have progressively deepened the scope and raised the political stakes of the aid effectiveness agenda.

- The 2003 Rome Declaration set out agreed commitments by the donor community to harmonise and streamline their aid activities with one another and created an international body – the DAC Working Party on Aid Effectiveness - which is tasked with carrying the initiative forward;
- In 2005, 130 countries and agencies signed off on the Paris Declaration (PD) thereby agreeing to fundamentally reform the delivery and management of development assistance with clear performance measures to be achieved by 2010.
- In early September 2008 – midway through the PD timeframe – the third High Level Meeting (HLF) in Accra culminated in an agreement on the Accra Agenda for Action (AAA). The AAA is a wide ranging programme of operational reforms that will change the way the aid business functions.

What distinguishes the Paris Declaration?

In an effort to "lock in" PD commitments, participating countries endorsed twelve indicators for monitoring progress regarding country ownership, alignment, harmonisation, managing for results and mutual accountability. The indicators apply to donors and partner countries alike, but the largest share relate to aid processes – including improving predictability, reducing missions, aligning with country priorities, and untying aid. Each indicator is underpinned by explicit, quantifiable targets to be reached by 2010.

Findings from 2008 survey: "Comparing overall results with figures for Africa"

The global results show that progress has been made particularly in the area of untied aid, technical co-operation, and the use of PIUs. However a considerable acceleration of change will be needed to achieve the targets set for 2010. Significant improvements are needed in the use of country systems and the co-ordination of donor missions.

The results for Africa show that there are a couple of areas where the picture is the same as the picture globally – aid untying and coordination of donor missions, with significant progress on aid untying, but much less on the coordination of donor missions where performance remains very poor. There are a couple of other areas where the picture in Africa is not as good as the picture globally – increasing the use of country systems, and reducing the number of parallel project implementation units, and indeed the picture on the former has actually got worse. There is a further area – aid predictability, where there has been improvement globally, but a decline in Africa – though predictability is still nonetheless better in Africa than globally.

Below shows the results of the survey across a handful of indicators for developing countries overall and specifically for Africa:

Significant improvements in the design of technical co-operation, both globally and in Africa – For indicator 4, the 2008 Survey shows that, globally, this target has already been exceeded and has progressed from 48% in 2005 to 60% in 2007. Figures for Africa show that there has also been an improvement from 43% in 2005 to 60% in 2007.

Global improvements in use of country systems, but a declining trend in Africa - For indicator 5, global progress has increased by 4 to 5 percentage points from 2005-2008, but this is still very modest compared with the targeted levels that require as much as 80% of aid to use country systems. The figures for Africa show that the use of PFM systems has declined 2% from 2005 to 2008 and use of country procurement systems has also declined for the same period at 1%.

The number of Project Implementation Units (PIUs) is declining at a faster rate globally than in Africa – For indicator 6, the overall total stock of parallel PIUs recorded in the 33 countries declined significantly: from 1817 in 2005 to 1601 in 2007. The figures for Africa, however, show that there has been a smaller reduction from 960 in 2005 to 902 in 2007.

Aid predictability has improved both globally and in Africa – For indicator 7, there has been an improvement from 41% in 2005 to 46% in 2007, however this is still far from the target of 71% which is to be reached by 2010. The average figures for Africa show that predictability has also improved slightly from 44% in 2005 to 48% in 2007.

Substantial improvements in the untying of aid globally and in Africa – For indicator 8, overall figures show an increase from 75% in 2005 to 88% in 2007. The share of untied aid in Africa has increased from 79% in 2005 to 91% in 2007.

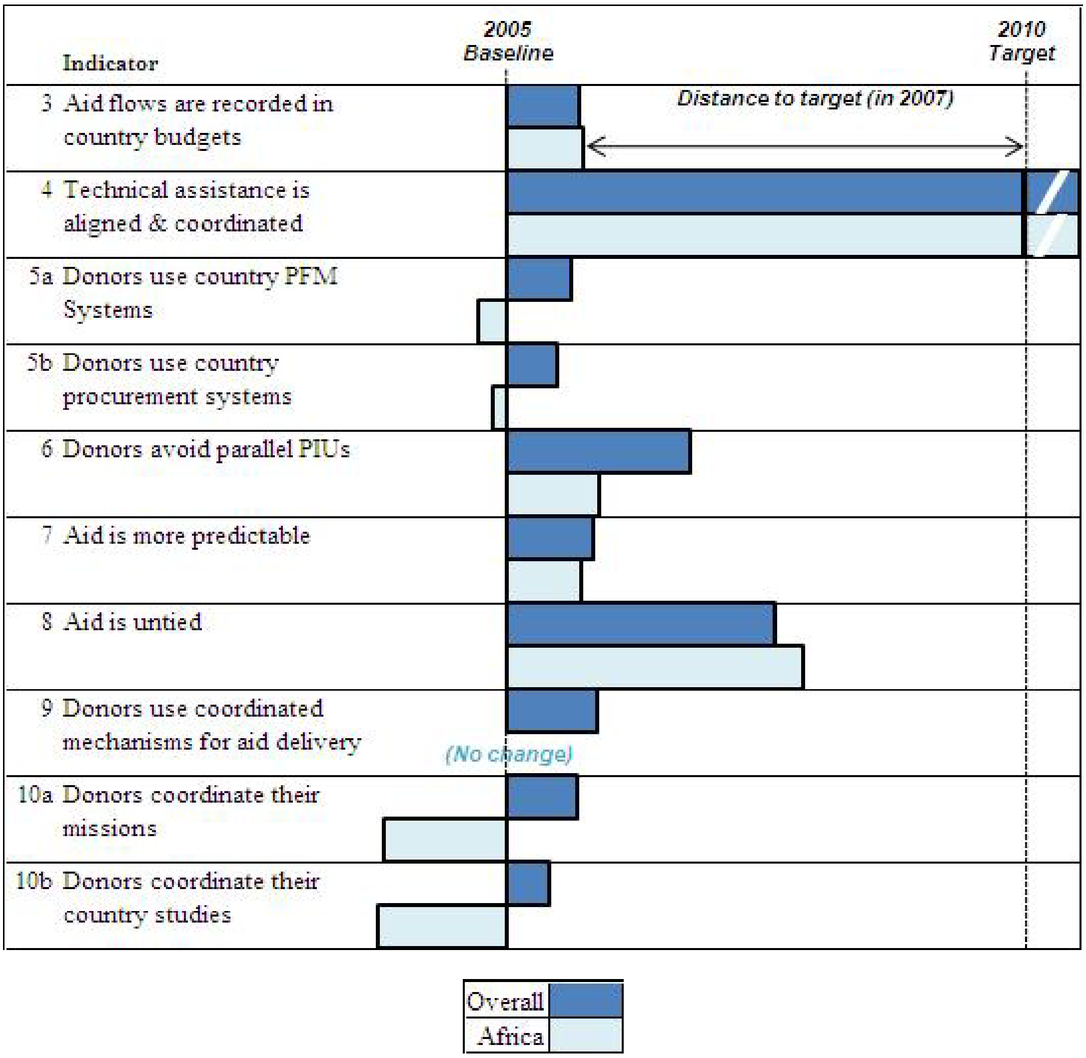
Very little progress in the co-ordination of donor missions, both globally and in Africa – For indicator 10a, global figures between 2005 and 2008 have increased from 43% to 46%. Figures for Africa show a reduction in the number of co-ordinated donor missions. In absolute terms, in 2007, out of a total of 5118 donor missions in Africa, only 726 were co-ordinated compared to 987 out of 5241 for 2005.

Note: The baseline survey was carried out in 33 developing countries in 2005, followed by a monitoring survey covering 54 countries in 2008.

Source: OECD-DAC, 2008 Survey of Monitoring the Paris Declaration.

20. *Country ownership*. In Accra, partner countries agreed to broaden country-level policy dialogue on development -- with stronger engagement with parliamentarians, civil society organisations (CSOs) and citizens in shaping development policies. Donors will support efforts to increase the capacity of all development actors -- parliaments, central and local governments, CSOs, research institutes, media and the private sector -- to take an active role in dialogue on development policy and on the role of aid in contributing to countries' development objectives. Together, developing countries and donors will jointly manage a demand-driven process of strengthening national capacity with an emphasis on: i) using local and regional resources through South-South co-operation and ii) a concerted effort by donors to use country systems, which will be the norm. Not using country systems will need to be clearly explained, justified and reviewed at regular intervals. Donors reaffirmed their Paris Declaration commitment to provide 66% of aid as programme-based approaches and to channel 50% or more of government-to-government assistance through country fiduciary systems.

Figure 6: Progress over the period 2005-2007 in meeting the Paris Declaration targets: comparing Africa to the rest of the world



Source: OECD-DAC, 2008 Survey of Monitoring the Paris Declaration

21. *Building more effective and inclusive partnerships.* In recent years, more development actors — middle-income countries, global funds, the private sector, civil society organizations, private foundations — have been involved in providing support to developing countries. While they bring additional (and sometimes substantial) financial contributions and valuable experience, the situation

creates management and co-ordination challenges. In Accra, all development actors have committed to work together in more inclusive partnerships. Enhancing the effectiveness of aid will require, especially at country and sector levels, reducing the fragmentation of aid by improving the complementarity of donors' efforts and the division of labour among donors, including through improved allocation of resources within sectors, within countries, and across countries. To this end: a) developing countries will lead in determining the optimal roles of donors; b) donors and developing countries will work together with the OECD/DAC Working Party on Aid Effectiveness to complete good practice principles on country-led division of labour.

22. *Achieving development results and being accountable and transparent about them* is at the heart of aid effectiveness. In Accra, countries and donors agreed to improve information systems and to develop cost-effective instruments to assess the impact of development policies and adjust them as necessary. Donors also agreed to align their monitoring with country information systems. Developing countries' national statistical capacity and information systems play a critical role. Developing countries will facilitate parliamentary oversight through public disclosure of revenues, budgets, expenditures, procurement and audits. Donors will publicly disclose regular, detailed and timely information on aid volumes, allocation and -- when available -- the results obtained through development expenditure.

23. *Mutual assessment reviews must be in place by 2010 in all countries that have endorsed the Paris Declaration* and together developing countries and donors will jointly review and strengthen existing international accountability mechanisms, including peer review with participation of developing countries. To strengthen country ownership and improve the predictability of aid flows, donors will work with developing countries to agree on a limited set of mutually agreed conditions based on national development strategies, and to regularly make public all conditions linked to disbursements. Finally, to increase the medium-term predictability of aid, donors have agreed -- effective immediately -- to provide full and timely information on annual commitments and actual disbursements and regular and timely information on their rolling three- to five-year forward expenditure and/or implementation plans, with at least indicative resource allocations

IV. What are the key priorities?

Actions by African countries:

- Exercise effective leadership in coordinating and harmonizing donor activities at the country level.
- Make efforts to be more accountable to domestic constituents to ensure that there is local accountability as well as genuine national ownership of aid policies and programs.
- Strengthen public financial management and procurement systems.
- Step up efforts to reduce long-term aid dependency.

Actions by development partners:

- Take concrete actions to meet commitments made on doubling aid to Africa by 2010, particularly in the difficult context of the fallout from the financial crisis and the impending recession in OECD countries.
- Make considerable efforts to reduce aid fragmentation and untie technical cooperation.
- Take concrete actions to reduce aid volatility by increasing transparency and providing more information on future aid flows.
- Give recipient countries more space to take effective leadership of their development strategies through reduction in policy-based conditionality and more focus on harmonized results-based conditionality.
- Support efforts to increase the capacity of all local stakeholders to take an active role in country-level dialogue on development.

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Annex Table 1: Simulation of ODA for 2006 (based on commitments made at Monterrey)

Country	Net ODA in 2002 (US $m)	ODA/GNI in 2002	Commitment/ Announcement/ *Assumption*	Year to be attained	Net ODA in 2006 (in millions of 2002 US $)	ODA/GNI in 2006	Real change in ODA in 2006 compared with 2002 (at 2002 prices and exchange rates)[1] (US $m)	Percent
Austria	475	0.23%	0.33%	2006	722	0.33%	248	52%
Belgium[2]	1,061	0.42%	0.7%	2010	1,479	0.54%	418	39%
Denmark	1,632	0.96%	*>0.7%*	n.a.	*1,568*	*0.85%*	*-63*	*-4%*
Finland	466	0.35%	*0.44%*	2007	600	0.42%	134	29%
France[2]	5,182	0.36%	0.5% (0.7% by 2012)	2007	7,229	0.47%	2,046	39%
Germany	5,359	0.27%	0.33%	2006	7,066	0.33%	1,708	32%
Greece	295	0.22%	0.33%	2006	476	0.33%	181	61%
Ireland[2]	397	0.41%	0.7%	2007	665	0.63%	268	68%
Italy	2,313	0.20%	0.33%	2006	4,195	0.33%	1,882	81%
Luxembourg	143	0.78%	1%	2005	198	1.00%	55	38%
Netherlands	3,377	0.82%	0.8%	Already	3,566	0.80%	189	6%
Portugal	282	0.24%	0.33%	2006	420	0.33%	137	49%
Spain	1,608	0.25%	0.33%	2006	2,328	0.33%	720	45%
Sweden	1,754	0.74%	1%	2006	2,582	1.00%	828	47%
United Kingdom	4,749	0.30%	0.4%	2005-06	6,888	0.40%	2,139	45%
EU Members, Total	**29,093**	**0.34%**	**0.39%**	**2006**	**39,984**	**0.43%**	**10,891**	**37%**
Australia[3]	962	0.25%	0.26%	in 2003-04	1,089	0.26%	126	13%
Canada	2,013	0.28%	8% annual increase	to 2010	2,739	0.34%	726	36%
Japan	9,220	0.23%	*1998-2002 av. Level ($10.5 bn)*	*in 2006*	*10,500*	*0.26%*	*1,280*	*14%*
New Zealand	124	0.23%	*Future level is under review*		*134*	*0.23%*	*10*	*8%*
Norway	1,746	0.91%	1%	2005	2,081	1.00%	334	19%
Switzerland[2]	933	0.32%	0.4%	2010	1,128	0.36%	195	21%
United States[4]	12,900	0.12%	Increase by $7 bn from 2001	2006	17,026	0.15%	4,126	32%
DAC Members, Total	**56,991**	**0.23%**			**74,680**	**0.28%**	**17,689**	**31%**

[1] Assumes average real growth in GNI of 2% p.a. [3% for Canada and zero for Japan] from 2002 to 2006.
[2] ODA/GNI ratio for 2006 interpolated between 2002 and year target scheduled to be attained.
[3] Estimated ODA/GNI 0.26%in 2003/04. As aid volume determined in annual budgets, assumes same ratio in forward years.
[4] Assumes, for 2006, additional $5 bn from the Millennium Challenge Account and $2 bn from the Emergency Plan for AIDS Relief, and 2% p.a. inflation in the USA to deflate from 2006 to 2002 prices.

Source : OECD/DAC

Annex Table 2: Performance of DAC Member Countries and Remaining Gaps to Meet the Gleneagles Targets

PROGRESS ON ODA TO SUB-SAHARAN AFRICA

	2007 ODA TO SUB-SAHARAN AFRICA ($ BILLIONS)	CHANGE 2006-2007	
		VOLUME	%
CANADA	0.904	-88	-9%
FRANCE	2.877	-66	-2%
GERMANY	2.720	311	13%
ITALY	1.097	417	61%
JAPAN	2.157	-197	-8%
UK	3.637	48	1%
US	5.414	413	8%
G8	**18.805**	**837**	**5%**
OTHER DAC COUNTRIES	**8.677**	**690**	**9%**
DAC TOTAL	**27.482**	**1527**	**6%**

	2004 ODA TO SUB-SAHARAN AFRICA[8] ($ BILLIONS)	TARGET ODA TO SUB-SAHARAN AFRICA IN 2010 ($ BILLIONS)	TOTAL CHANGE IN ODA TO SUB-SAHARAN AFRICA 2004-07[9]	% OF INCREASES ACCOMPLISHED BY END OF 2007 TOWARDS 2010 COMMITMENT
CANADA	0.832	1.5	72	10.8%
FRANCE	2.542	7.529	334	6.7%
GERMANY	2.234	6.204	485	12.2%
ITALY	1.139	4.793	-43	-1%
JAPAN	1.59	2.235	567	100%*
UK	2.6	6.508	1037	26%
US	4.833	8.8	581	15 %
G8	**15.770**	**37.568**	**3035**	**14%**
OTHER DAC COUNTRIES	**7.777**	**12.076**	**900**	
DAC TOTAL	**23.548**	**49.644**	**3934**	

* Though Japan is shown here as having achieved its commitment, it should be noted that this commitment was only to double bilateral aid from 2003 levels. In selecting 2003 for its Africa commitment, Japan chose the year with the lowest bilateral spending in the previous decade – ¥60 billion ($561 million). This was not an ambitious commitment and does not contribute significantly to the overall increases to which the G8 committed.

Note: The figures shown in this table are expressed in 2004 constant prices and exchange rates and are therefore different from the numbers shown in Table 1 in the text which are expressed in current 2007 prices and exchange rates.

Source : DATA Report 2008

FOCUS ISSUE 4: EXTERNAL DEBT

I. Overview of commitments

Africa:

Monterrey Consensus, 2002

- The Monterrey Consensus noted that external debt relief could play a key role in liberating resources that could then be directed towards activities consistent with attaining sustainable growth and development.
- National comprehensive strategies to monitor and manage external liabilities, embedded in the domestic preconditions for debt sustainability, including sound macro-economic policies and public resource management, are a key element in reducing national vulnerabilities. Debtors and creditors must share the responsibility for preventing and resolving unsustainable debt situations.

Development Partners:

Monterrey Consensus, 2002

- Called for a speedy, effective and full implementation of the enhanced HIPC initiative and indicated that this should be financed through additional resources.
- Encouraged donors to take steps to ensure that resources provided for debt relief do not detract from ODA resources intended to be available for developing countries.
- Urged heavily indebted poor countries to take the policy measures necessary to become eligible for the HIPC initiative.
- Technical assistance for external debt management and debt tracking can play an important role and should be strengthened.

G8 Summit Declarations, 2003-2007

- At Gleneagles, Leaders of G8 countries committed to cancelling 100% of outstanding debts of eligible HIPC to the IMF, IDA and African Development Fund, and to provide additional resources to ensure that the financing capacity of the IFIs is not reduced. These Multilateral Debt Relief Initiative (MDRI) commitments were reaffirmed in St. Petersburg in 2006 and Heiligendamm in 2007.
- At Evian, the G8 Summit adopted the Evian approach to Paris Club debt relief which is more flexible and can provide debt cancellation to a greater number of countries (including middle-income countries) than was available under prior Paris Club rules.

World Summit Outcome, 2005

- Leaders resolved to promote a comprehensive and durable solution to the external debt problems of African countries, including through cancellation of 100 % of multilateral debt consistent with the G8 proposals for heavily indebted poor countries, and, on a case-by-case basis, where appropriate, significant debt relief, including, inter alia, cancellation or restructuring for heavily indebted African countries not part of the HIPC initiative that have unsustainable debt burdens.

II. What has been done to deliver on these commitments?

Africa:

- Addressing Africa's debt problem has been a major challenge for policymakers in the region as well as development partners. The Heavily Indebted Poor Countries (HIPC) initiative of 1996, the enhanced HIPC initiative of 1999 and the Multilateral Debt Relief Initiative (MDRI) of 2005 are key attempts by development partners to deal with this problem stifling growth in African economies. Of the 27 African countries that were eligible for either debt relief or reduction under the HIPC programme in July 2008, 19 have reached the completion point and 8 are between decision and completion points. The other six pre-decision point countries—Comoros, Côte d'Ivoire, Eritrea, Somalia, Sudan and Togo—are either in a conflict or post-conflict situation or lack a clear development strategy. Table 1 presents the status of the 33 African countries that are part of the HIPC programme.

Table 1. List of Heavily Indebted Poor Countries (as of end-July 2008)

19 Post-Completion-Point Countries [1/]		
Benin	Malawi	São Tomé and Príncipe
Burkina Faso	Mali	Senegal
Cameroon	Mauritania	Sierra Leone
Ethiopia	Mozambique	Tanzania
Ghana	Niger	Uganda
Gambia, The	Rwanda	Zambia
Madagascar		
8 Interim Countries [2/]		
Burundi	Congo, Dem. Rep. of the	Guinea-Bissau
Central African Rep.	Congo, Rep. of	Liberia
Chad	Guinea	
6 Pre-Decision-Point Countries [3/]		
Côte d'Ivoire	Eritrea	Sudan
Comoros	Somalia	Togo

Notes: [1/] Countries that have reached completion points and therefore qualify for irrevocable debt relief under the enhanced HIPC Initiative and have received MDRI relief. [2/] Countries that have qualified for assistance under the enhanced HIPC Initiative (i.e. reached decision point), but have not yet reached completion point. [3/] Countries that are potentially eligible and may wish to avail themselves of the enhanced HIPC Initiative.

Source: IMF/WB, Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI)—Status of Implementation, October 2008.

- Debt management systems have improved although only marginally in sub-Saharan Africa where half the countries are considered to have satisfactory setups in place according to the World Bank's Country Policy and Institutional Assessment (CPIA).

Development Partners:

- Substantial progress has been made in the implementation of the HIPC Initiative. More than 80% of eligible countries (27 out of 33)[22] have passed the decision point and qualified for HIPC Initiative assistance and qualified for irrevocable debt relief under the HIPC Initiative and MDRI, most of them since the Monterrey conference. In the past year, the Central African Republic and Liberia reached the decision point and The Gambia the completion point.
- Further debt relief has been provided through the MDRI to accelerate progress towards the MDGs. The MDRI was proposed in June 2005 by the G-8 and was implemented in 2006 by the IMF, IDA, and the African Development Fund (AfDF). Under the MDRI, 100% of these institutions' eligible debt claims on countries that reach the completion point under the HIPC Initiative are cancelled.[23] The objective was to provide substantial additional debt relief to free up resources to help HIPCs reach the MDGs.
- The overall assistance committed to the 27 post-decision-point HIPCs in Africa amounts to US$90 billion (in nominal terms), mostly in the form of HIPC Initiative and MDRI relief. This represents on average about 50% of these countries' 2007 GDP. Multilateral financial institutions which account for 46% of the total estimated cost of HIPC initiative debt relief and Paris Club bilateral creditors (36% of the total cost) participate fully in the initiative. It is estimated that non-Paris Club creditors only deliver 40% of the expected debt relief
- Under the Evian approach, development partners have also taken some actions to deal with debt problems of non-HIPC African countries. For example, Nigeria is one of the countries that have benefited from debt relief under this programme.
- Flexibility has been applied in implementing the Initiative to facilitate HIPCs' progress towards debt relief, specifically in the areas of eligibility criteria, the establishment of a track record of policy performance, requirements on poverty reduction strategy papers, delivery of interim relief, facilitation of early clearance of arrears, and fulfilment of completion point triggers. The impact of exogenous factors on debt relief recipients has also been taken into account.
- Several OECD countries and the Bretton Woods institutions have provided technical assistance to African countries for government debt issuance and management. To help countries avoid law suits by creditors who do not participate in the HIPC process, the World Bank and other donors have proceeded with buying back commercial debt at a discount, thus clearing the part of the debt which is not covered by the HIPC Initiative.

III. What are the results?

1. Total debt stock reduction has been significant: As shown in Table 2 and Figure 1, Africa's total external debt stock decreased from US$298 billion to US$245.9 billion over the 2000-06 period. It is projected that the stock of external debt of post-completion-point countries will be reduced by more than 90% in end-2007 NPV terms. Most of this reduction would be delivered in the context of the HIPC Initiative and the MDRI. The remainder is attributable to traditional debt relief and voluntary bilateral debt relief beyond HIPC. Debt stocks in the 8 interim period countries are expected to decline by a similar factor.

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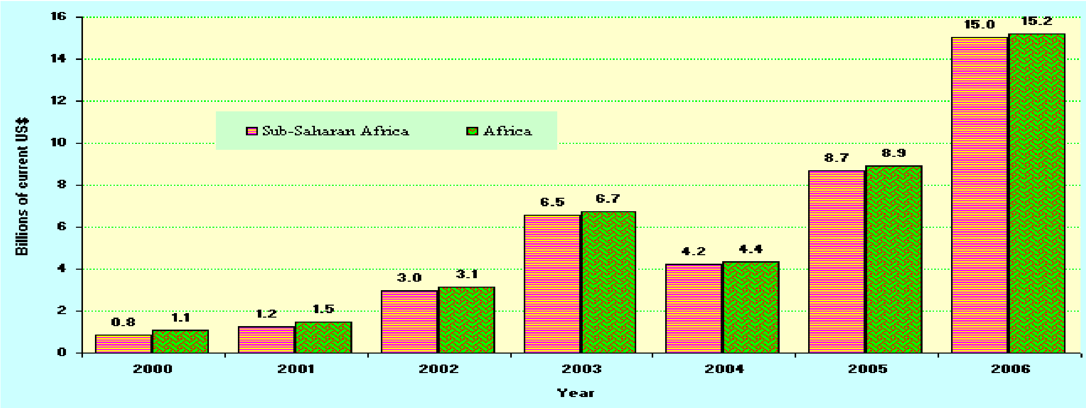
[22] Globally, the percentage is slightly lower: 33 out of the 41 HIPC eligible countries have reached the completion point.
[23] MDRI debt relief covers debt disbursed before end-2004 (for the IMF, and AfDF) or end-2003 (for IDA) and still outstanding at the time of qualification after HIPC Initiative debt relief.

Figure 1: Net Debt Relief, 2000-2006 (current US$ billions)



Source: OECD Stat, DAC Online Database

2. **Significant progress has been made in reducing the burden of external debt**: The ratio of external debt to gross national income (GNI) in Africa decreased from 55.1 % in 2002 to 24.2 % in 2006. Most of the recent decline in the external debt of Africa is due to the implementation of the MDRI introduced in 2005. It is also a consequence of the very large debt relief received by Nigeria and the improvement in the growth performance of several countries in the region. However, total debt service paid rose from US$24.5 billion in 2002 to US$42.9 billion in 2006 due largely to the high payments made by Nigeria (as part of the commercial debt buy-back arrangement where Nigeria had to pay US$6 billion up front to get a write-off for the remaining debt) and Algeria in 2006. It is projected that debt service payments expressed as a share of GNI will fall sharply as the MRDI process kicks in for more countries. The debt service ratio (debt service over exports) for these countries is estimated to have declined from an average of about 17% in 1998–99 to about 4% in 2006.

Table 2: External Debt Data for Africa

	2000	2001	2002	2003	2004	2005	2006
	Total External Debt (billions of current US$)						
Africa	298.7	287.0	298.4	320.9	330.3	297.9	245.9
Sub-Saharan Africa	211.9	203.9	212.7	230.4	239.1	216.3	173.5
	Total Debt Service (billions of current US$)						
Africa	24.4	24.3	24.5	24.1	24.1	33.2	42.9
Sub-Saharan Africa	13.5	13.9	13.1	11.3	11.2	20.1	21.4
	Total External Debt (% of GNI)						
Africa	56.2	54.4	55.5	50.6	44.4	34.5	24.2
Sub-Saharan Africa	65.7	64.1	63.9	55.9	47.7	36.7	24.6
	Total Debt Service (% of GNI)						
Africa	4.6	4.6	4.6	3.8	3.3	3.9	4.5
Sub-Saharan Africa	4.2	4.4	4.0	2.8	2.3	3.5	3.3

Source: World Development Indicators Online Database & OECD.Stat, DAC Online database

3. **Commercial creditors have markedly increased their delivery of HIPC Initiative relief:** commercial creditors only account for 6 % of the total HIPC Initiative cost and delivery of the related relief had so far constituted a challenge, with participation in the low single digits until last year. This share increased significantly after the authorities of the Republic of Congo reached a debt restructuring agreement with their commercial creditors, organized as a creditors' committee (previously known as the London Club**).** Two successful commercial debt buybacks supported by the World Bank Debt

Reduction Facility (DRF) for Mozambique and Nicaragua (another one is under preparation for Liberia) also contribute to the improvement. Notwithstanding overall progress, the debt picture is still mixed.

4. **Challenges of coordination among creditors for a full delivery of debt relief by all non-PC bilateral creditors and private creditors remain**. With the increasing role of private creditors and emerging bilateral creditors, there is a need for greater creditor coordination. One possible avenue is to broaden the membership of the Paris Club to include non-member creditors and commercial creditors. Another is the establishment of more universal guidelines outside the Paris Club framework, covering all creditors, with developing countries playing a leading role. This requires increased inter-creditor coordination, particularly taking into account the increasing role of private creditors and emerging bilateral creditors, such as China and India.

5. **The problem of litigating creditors against some developing countries, including HIPCs, has to be addressed**. Court cases have been filed by commercial creditors and vulture funds against 12 HIPCs over the past decade. The HIPCs facing the most litigation cases are Liberia, the Republic of Congo, Uganda, and Sierra Leone. Efforts needed to deal with this problem include moral suasion, debt buybacks and Paris Club creditors not reselling claims in secondary markets. Technical assistance to HIPCs in capacity building in debt management and sound legal expertise to respond to litigators is important as well.

6. **Debt sustainability remains an issue in conflict and post-conflict countries.** Completing the implementation of the HIPC Initiative will entail mobilizing additional resources to finance debt relief to all remaining HIPCs. Three pre-decision-point HIPCs—Comoros, Côte d'Ivoire, and Togo—are making progress towards the decision point. Last year, Côte d'Ivoire and Togo cleared arrears to major creditors, including IDA and IMF, and are on track with the implementation of their IMF-supported programs and are expected to reach the decision point within the next year. Comoros cleared its arrears to the AfDB and, following the resolution of a short internal conflict, has indicated renewed interest in a Fund-supported program.

7. **Debt relief has provided more fiscal space for poverty reduction.** Before the HIPC Initiative, eligible countries were, an average, spending slightly more on debt service that on health education combined. Now, spending on health, education and other social services is about five times the amount of debt service payments. A key issue has been sidelined – often debt relief has not taken into account financing needs for productive and infrastructure investment.

8. **But development needs are much larger than debt relief in HIPCs and new financing has begun to threaten debt sustainability again**. Debt relief savings accrue through time and for most countries, constitute only a fraction of net aid inflows to HIPCs where development needs therefore requires larger new resource flows including aid. These new flows need to be on appropriate terms to make sure that debt sustainability, which has been restored through debt relief, is maintained in the future. Despite the recent gains that have been achieved in this area, there is concern that debt ratios are beginning to deteriorate in several post-completion point HIPC countries in the region. A recent study shows that 14 of the 23 post-completion-point HIPCs are at either moderate or high risk of debt distress (World Bank 2008a).

9. **Bond flows and bank debt have increased the vulnerabilities of several HIPCs.** While negligible before the 1990s, they now accounts for over a quarter of developing countries' debt stock. This poses several challenges to debt policy planning as external factors play a more determining role and the sources of volatility are beyond the direct control of domestic financial authorities. South-South syndicated bank loans have acquired an increasing importance. While this form of finance only accounts for approximately 5% of bank lending to developing countries, it is growing rapidly and it has become an important source of finance in sub-Saharan Africa, where South-South lending represents 20% of total syndicated bank loans. Like other developing regions, Africa also observed an increase in their share of short-term debt that adds to the challenges in debt management.

10. **Long-term debt sustainability remains a challenge in many post-completion-point countries:** Despite the significant decline of debt burdens, over 50% of post-completion-point HIPCs have a moderate to high risk of debt distress according to the most recent debt sustainability analysis (DSA). The trend is even more worrisome with a sharp increase in the number of HIPCs with a high risk of debt distress rating in the past year. As of end-June 2008, Burkina Faso, The Gambia, Rwanda, and São Tomé and Príncipe had a high risk of debt distress. This situation needs a comprehensive strategy. In addition to a more systematic use of debt sustainability analysis, reducing the vulnerability of debtor countries requires also shared responsibility between debtors and creditors for preventing and resolving unsustainable debt situations and the strengthening of technical assistance for debt management and debt tracking.

IV. What are the key priorities?

Actions by Africa:

- The challenge for countries receiving HIPC and MDRI debt relief is to ensure that new borrowings from emerging official and private creditors and from domestic sources do not lead to renewed debt built-up, potentially jeopardising these countries' newly-restored capacity for borrowing to finance development. The application of the debt sustainability framework by both low-income countries and their creditors can help mitigate these risks.
- Enhance debt management and sustainability.

Actions by development partners:

- Provide more technical assistance to strengthen public debt management capacities in African countries.
- Intensify efforts to discourage lawsuits against HIPCs by non-Paris club creditors.

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Focus Issue 5: Impact of Recent International Developments on Africa

I. Introduction

1. In recent years countries in sub-Saharan Africa have enjoyed some of their highest growth rates in decades thanks partly to favourable external conditions[24], in addition to improved domestic policies. As a group, African countries also experienced lower inflation and oil-importing countries have registered more sustainable fiscal and external deficits. While international reserves remained practically unchanged over the period, by 2006 most oil-importing countries – leaving out fragile states – had exceeded the equivalent of three months of import coverage, which is considered a minimum (Table 1). Thus, as a group, SSA economies were much better equipped to deal with exogenous shocks.

Table 1: Key Economic Indicators

	1997-2002	2003-05	2006	2007	2008 a/
Real GDP growth, all SSA (%)	4.1	6.1	6.3	6.7	4.5-5.9 b/
Inflation rate, all SSA (%)	13.3	9.0	7.3	7.1	11.7
Overall fiscal balance, oil-importing countries, excluding South Africa c/ (% of GDP)	-5.8	-6.1	-5.7	-5.5	-6.7
External current account (including grants), oil-importing countries, excluding South Africa (% of GDP)	-7.8	-6.9	-7.2	-8.4	-10.3
International reserves, oil-importing countries, excluding South Africa (months of imports of goods and services)	5.1	5.1	4.6	4.8	4.1

Notes: a/: estimates; b/: range of projections for 2008. The average GDP growth rate for SSA depends to a large extent on South Africa's growth performance. More recent estimates show lower figures; c/: the last three indicators reflect the situation of oil-importing countries, excluding South Africa which shows significantly better figures than the rest of the oil-importing countries. Due to the impact of high oil prices that affect both exports and government revenue, the trend of the last three indicators is less meaningful for oil-exporting countries.

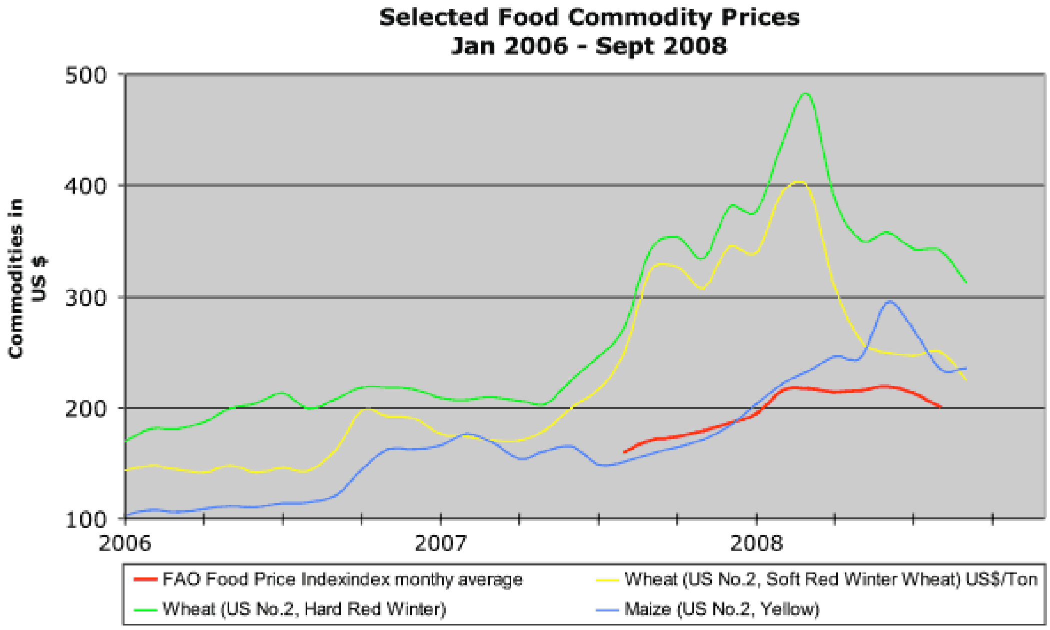
Sources: IMF (2008) and unpublished World Bank estimates.

2. Since late 2007, the external environment affecting developing countries has experienced a significant deterioration. First, sharp rises in food and fuel prices that culminated in the first half of 2008 (Figure 1) have forced African countries, many of whom are net food importers, to take actions to alleviate the impact of higher import prices through price controls, consumer subsidies and tax reductions on foodstuffs and fuels. As shown in the last column of Table 1, the impact of higher import prices and policy responses to address high food and fuel prices have led to a significant worsening of the macroeconomic conditions in most African countries, including higher inflation, deteriorating fiscal and external balances and reduced levels of foreign currency reserves to cover import costs.. The global financial crisis that emerged in September 2008 and its aftermath presents Africa with major additional challenges. In the short term, these range from outflows of funds (portfolio equity) triggering severe corrections in equity markets, particularly in countries that are more fully integrated to the world financial system, to the drying up of private capital inflows (portfolio equity, commercial lending and bonds). In the medium term, the expectation of protracted

[24] Strong growth in the industrialized and emerging economies have led to increased export revenues and higher commodity prices, a surge in foreign direct investment, and increased remittances from abroad.

low growth in OECD countries threatens Africa's export and growth prospects, and lower flows of external funding -- including remittances -- would constrain investment as well as consumer spending.

Figure 1: Commodity Prices



Source: Adapted from World Bank unpublished document. Original data form FAO

3. For clarity's sake and to have a more logical presentation of the policy recommendations, this chapter will have two sections. The first section covers the impact of higher food and fuel prices on African economies which are more or less known. The impact of the financial crisis and its aftermath will be covered in the second section. As the financial crisis and its aftermath are still unfolding, assessing their impact on medium-term growth prospects and contagion risks to financial markets in sub-Saharan Africa are more speculative; the discussion will be restricted to identifying and discussing the channels through which the financial crisis in OECD countries can impact the financial systems in Africa.

II. The impact of food and fuel price shocks

4. **Inflationary pressure is a major concern in the near term.** Despite sharp declines in recent months, international food and fuel prices remain significantly higher than 2007 levels (Figure 1) and are expected to remain high for the next several years on account of global food supply and demand imbalances. The average inflation for 38 African countries with recent data is about 14.3% while food inflation is reaching 20.3% a year[25]. This is a substantial reversal of the single digit inflation achieved by African countries over the past 5 years. There are also indications of possible second-round inflationary effects, suggesting that inflation may be starting to increase beyond what is justified from the increase in the prices of food and fuels alone. In particular, wage increases appear to have accelerated in 8 out of the 14 countries for which wage data are available. Furthermore, domestic fuel prices might increase still further when fuel subsidies, introduced in 2008 to cushion the impact of high prices on the consumers, are progressively phased out for fiscal sustainability reason.

5. **Poverty concerns are real and significant and the pressure for governments to act is high.** Food and fuel price increases could lead to a substantial increase in poverty rates in a number of

[25] This is the case, for example, in Ghana and Ethiopia, where public investment in infrastructure has been growing at a sustained pace. Ethiopia's year-over-year inflation reached over 60 percent in August. Five other countries have inflation rates exceeding 20%.

countries, given that average households in sub-Saharan Africa spend about half of their income on food. A recent study finds that if domestic prices of important traded food commodities were to rise by the same percentage as their world market prices, the poverty head count in low-income African countries could rise by as much as 4 to 5 percentage points.

6. **The costs of the above measures and higher cost of imports have led to the deterioration of fiscal and external balances.** It was estimated that measures to cushion the impact on households cost, on average, about 0.5% of GDP in 2008 -- but for a few countries the cost could exceed 2% of GDP. This raises the issue whether these measures are fiscally sustainable. Furthermore, subsidies, and in particular fuel subsidies, are poorly targeted and accrue largely to the non-poor. On average, the current account deficit is projected to deteriorate by the equivalent of 2% of GDP in 2008, with several countries experiencing a larger balance of payments shock. For 17 African countries, including Malawi, Ethiopia, Guinea and Liberia, the shock is equivalent to losing half of the country's foreign exchange reserves.

7. **Preserving macroeconomic stability while shielding the poor from the impact of food and fuel shock could pose major economic policy challenges.** On the one hand, inflationary pressures and the sharp deterioration of the fiscal and external balances, particularly in countries with very low international reserves, would require some tightening of both monetary and fiscal policy. At the same time, it is important to fully pass through external price changes over time to encourage domestic economic actors to adjust, avoid permanent increases in untargeted and inefficient subsidies, and preserve fiscal and balance of payments sustainability. But the poor also need to be protected through well-targeted measures,[26] -- and this raises difficult macroeconomic management challenges given that deteriorating fiscal balances limit the fiscal space available to governments for cushioning the impact on the poor. Public investment in infrastructure, crucial to promoting economic growth, is also likely to be curtailed.

III. The impact of the financial crisis and its aftermath

8. **There are two main impacts of the recent financial crisis**. First, and more straightforward to identify, are the consequences of the sharp economic growth slowdown expected in OECD countries which would negatively affect export and growth in African countries. A complicating factor of the analysis is the lack of a clearer view on the extent to which the level of economic activity in major emerging economies -- such as China and India who are major foreign investors in Africa -- is closely connected with that of the industrial countries. Second, the financial crisis that started in the U.S. and has since spread to Europe and other parts of the world will most likely have an impact on the financial systems in sub-Saharan Africa. Because little is known about the intensity and geographical spread of this impact, the discussion, as stated earlier, will concentrate on the possible channels of contagion.

A. Impact on exports, growth and financing

9. The rapid pace of trade expansion in this decade is expected to decelerate sharply and African countries may also suffer from declines in terms of trade. The IMF recently projected growth in world trade volumes of just 4.1% in 2009, down from 9.3% as recently as 2006. More recent projections by the World Bank show that the deceleration could be much more rapid and that trade volumes may run the risk of physically contracting in 2009. The slowdown in economic activity in OECD countries is also expected to cause non-oil commodity prices to fall -- by perhaps one-fifth -- in 2009.

10. **External sources of funds for investment, which have played an important role in recent years, are likely to drop off sharply**. Portfolio investment, bond flows and commercial lending will likely fall, as greater risk aversion keeps capital closer to home. While FDI is historically more resilient to shocks, it, too, is expected to decline. And as labor markets slacken in OECD countries,

[26] With the help of the World Bank and other external partners, over 15 African countries are developing and scaling up their social assistance programs, such as school feeding, food-for-work, and cash transfer programs.

foreign workers are likely to suffer disproportionate impacts on their earnings, which will reduce remittances[27]. While Africa relies relatively more than other developing regions on official development assistance as a source of financing, total net private capital flows to Africa including North Africa reached a record high level of US$81 billion in 2007, of which about US$28 billion went to North Africa. In 2007, Gabon, Ghana and Nigeria were successful in raising a total amount of US$5.8 billion in the Eurobond market (see Table 1 of Focus Issue 2). Remittances added another US$19 billion to sub-Saharan Africa in 2007. Together with the fact that over three-quarters of African oil importers has external deficits larger than 5 % of GDP[28], African economies are vulnerable to swings in these various sources in external financing.

11. **Unless official development assistance will rise, African governments will have limited scope to expand domestic demand through fiscal stimulus.** Well-designed investments such as building infrastructure as a way of generating domestic demand can partly offset the expected decline in foreign demand. But in a larger sense, the deterioration of the macroeconomic framework, as discussed above, will effectively curtail the magnitude of counter-cyclical fiscal policy.

B. Possible contagion effect on financial systems

12. Direct contagion effects have thus far been limited but African financial systems are more vulnerable to international financial turbulence than before. On the whole African banks are not exposed to risks arising from complex derivative instruments nor – being relatively liquid – have banks relied substantially on foreign borrowing to fund their lending. South Africa may be the exception with the most developed and internationally integrated financial system in sub-Saharan Africa.

13. **High levels of foreign bank ownership could potentially expose African financial systems to risk from international contagion**. In 11 sub-Saharan African countries, foreign ownership of local banks exceeds 50%. Ownership of banks by parent institutions in Western Europe is a potential transmission mechanism, but the potential negative impact appears to be contained. Financial distress among the parent foreign banks could be transmitted to sub-Saharan Africa financial systems through either: (i) a withdrawal of capital; and/or (ii) calling in of loans made by the parents to their African subsidiaries. Also, the dominance of South Africa’s and more recently Nigeria’s financial systems within the region could cause a deterioration of the financial markets in these countries to reverberate in neighbouring countries.

14. **Large portfolio equity flows in South Africa totalling over US$35 billion in the past four years introduce a relatively high degree of risk**. Nigeria and Ghana are the other countries that have relied relatively heavily on foreign syndicated borrowing (for Nigeria) and foreign Eurobond borrowing, including last years’ oversubscribed issuance of US$750 million by Ghana. Also, while FDI is still concentrated in resource-rich countries, 35 sub-Saharan African countries have managed to attract FDI flows in the past few years. As a result, for almost half of Africa, FDI flows contribute more than 20% of fixed investment. The reduction in global liquidity and increased risk aversion that is pushing spreads upwards and increasing the costs of finance makes it unlikely that Sub-Saharan African emerging markets will be able to place primary bond issues at acceptable interest rates in the short-term.

15. **There are signs that trade financing is becoming scarce**. While the bulk of trade credit used in Africa is in the form of letters of credit, cash crop growers in West Africa rely more on syndicated loans to cover their trade financing needs. They therefore face a higher risk of disruption in trade finance either through higher trade credit costs or reduced funding, or both.

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[27] After several years of strong growth, remittance flows to developing countries began to slow down in the third quarter of 2008.

[28] Compared to about half of all developing countries have been running current account deficits of 5% of GDP or more.

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Annex 1

MUTUAL REVIEW OF DEVELOPMENT EFFECTIVENESS: LIST OF CONTENTS

Economic Commission for Africa
www.uneca.org

Organisation for Economic Co-operation and Development
www.oecd.org