REVERSING THE DECLINE OF ODA: HOW EFFECTIVE IS THE CURRENT POLICY AGENDA?

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EXECUTIVE SUMMARY

The world community has been confused by the contrast between, on the one hand, a number of problems that have been identified by a series of United Nations conferences at the summit or ministerial levels in the 1990s and, on the other hand, the declining trend of official development assistance (ODA) which has been the traditional means to support the international community to solve these problems. It is important for the global community to reflect on the reasons and the basis of ODA and to analyze them historically. It should then become apparent that the basis of ODA has changed fundamentally. It is for the international community to attempt to bring ODA and other financial instruments to bear upon the problems and issues identified globally in the light of the new reality.

The essence of the new reality is that the basic forces that organize the world community have changed from the cold war to two "tracks" of globalization. Market-based globalization is quick to impact on the world community and is, thus, the fast track, whereas political economy globalization is taking a longer time to form an alliance and to make itself felt in international society and is, thus, the slow track. For the time being, the fast track globalization is providing the basic structure to the world community, including the developing world, which has been divided into three categories, and at the same time it is pushing the global community to recognize the importance of global public goods.

The task of the international community in promoting sustainable development is to develop a proper strategy in this context. It is important to address the question of declining ODA as an integral part of this strategy. The essence of the strategy should be to approach the subject in phases. The basic objective of the first phase is to arrest the declining trend of ODA. It is important to articulate a package of policy instruments, each of which should be a realistic one. However, put together, they should impact critically on the world community where the atmosphere of international cooperation is expected to be strengthened. The first phase should start now and continue for several years.

The second phase should be to address the ODA question in a more dramatic manner, including the introduction of international taxation on a selective basis. While the start of the second phase may come around 2010, the world community should start conceptualizing its work now. Negotiations for this phase might have to begin immediately after Rio plus 10.

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INTRODUCTION

WHILE aid fatigue began to be mentioned in the late 1950s, aid activities have been an important feature in world affairs in the past several decades. The recent decline in ODA, while not a significant one, provides the world community with a stronger challenge than previous episodes of ODA decline such as in the late 1960s. Relating mainly to the end of the cold war and to the predominance of market-based globalization forces, both of which require considerable readjustments in political and economic arrangements in practically all countries, including donor countries, reversing the recent declining trend of ODA should be attempted mainly from a politico-economic perspective. Putting ODA into the new reality of the political economy of the world community should be the priority concern.

The conceptual work has to be firmly based on the reality characterized by rapid changes domestically as well as world-wide. Individual countries are witnessing increasing nationalism against the background of powerful forces of market-based globalization. It is not useful to introduce super-national approaches such as international taxes in whatever form in this situation. These may be easily ignored, or worse still, may invite backlash. It is imperative for the conceptualization of a new approach to aid for sustainable development to start with the fact that all the donors now consider aid as an integral part of their foreign policy.

One useful approach in this situation is to conceptualize the process of reversing the declining trend of ODA in phases. The major objective of the first phase is to arrest the declining trend and to begin to reverse it. The second phase is to begin to take somewhat more bold measures. The degree of boldness may depend on the politico-economic environment at the end of the first phase. By taking a phased approach, the world community may be able to avail itself of more realistic and powerful options than to try and reverse the declining trend of ODA through a shock therapy.

RISE AND FALL OF POLITICAL MANDATES FOR DEVELOPMENT FINANCE

External development finance has a relatively short history, originating in the late 1940s. It has responded mainly to the political requirements of the leading powers of the time, rather than the needs of the people. International relations and the reason of the state of the states have been the major motivating forces, whereas economics and ethics have contributed to the fine-tuning of its operations. Similarly, in the current situation, consideration of ways to strengthen external finance for sustainable development should centre around the present world politico-economic reality. In order to effectively approach this question, it is useful to briefly review the history of political mandates for external development finance and to observe their rise and fall in the world community.

The Aftermath of World War II

The triumvirate of the International Monetary Fund (IMF), the International Bank for Reconstruction and Development (IBRD), and the still-born International Trade Organization were basically conceptualized to avoid the recurrence of the Great Depression of 1929. The heavy war-time debt of Great Britain was, however, the immediate concern of Lord Keynes, negotiating for the United Kingdom, and Dr. White, Treasury Secretary, negotiating for the United States. These were a set of activities that took place along the lines of concern of treasury departments.

Another set of activities took place along the lines of foreign ministries. Significant changes in the drafts of the United Nations Charter from Dunbarton Oaks (1944) to San Francisco (1945) were the reflection of the shift of views of major Allied Powers with regard to the causes of wars. The Dunbarton Oaks draft dealt mainly with the peaceful resolution of conflicts and the enforcement of peace, generally matters that would be dealt with by the Security Council. The major development in the Charter drafting since then was to strengthen social and economic clauses that came to be incorporated in the San Francisco draft. This change was due mainly to the perception, gradually shared by the negotiators as the debates progressed, that a major root-cause of war was poverty. International efforts to alleviate poverty had come to be considered as an important means to strengthen peace. These two sets of institutions having been established on the part of the leading power, the United States, the reconstruction of Europe (the Marshall Plan), followed by efforts to reach out to the newly born poor countries in the form of Point Four (technical assistance in the inaugural address of President Truman in 1949), were presented as civilizational missions. The objectives of the Bretton Woods institutions, of the United Nations and the concerns of the United States began to get the international community involved in the efforts to alleviate poverty in the under-developed world in the late 1940s. The enormity of the challenges was not well understood by the leaders of these institutions.

Decolonization

The operations of the World Bank in the former British colonies began to fill the vacuum created by the withdrawal of the United Kingdom. With over 75 per cent of British investment in its former colonies from 1870 to 1938 being related to construction of ports and railroads and to energy, the initial operations of the World Bank were largely concentrated in these areas. The term economic infrastructure was given to them, and they were justified as proper areas for external public finance.

While the United Kingdom initially refused to aid newly independent former colonies financially, in 1950 it created the Colombo Plan mainly for the transfer of technology. One major reason for British refusal to aid former colonies was that it had invested sufficiently in them before independence. However, it became clear that most of the newly independent countries were not well equipped to be full-fledged nation-states in the world community. Being financially in a difficult situation, the United Kingdom resorted to technical co-operation to fill in this gap.

The independence of French colonies was achieved later, culminating in the independence of 17 African countries in 1960. However, practically all of these countries required continued aid from France for their proper function as sovereign states. France became a major donor country in the 1960s.

The Cold War

It was the cold war that critically motivated the United States and the Soviet Union to develop aid programmes to underdeveloped countries in the 1950s and 1960s. The increase of the Soviet aid was substantial in the 1950s, extending mainly to neighbouring countries to strengthen communist parties in these countries. The aid programs of the United States competed with these efforts of the Soviet Union, and also expanded significantly through the 1950s. The level of aid activities of the Soviet Union was almost one third of that of the United States in the mid-1950s.

North-South relations

The aid activities of the industrialized countries were motivated mainly by these three factors, namely the end of World War II, decolonization and the cold war, in addition to altruistic motives. Developing countries attempted to maximize gains from them by resorting to a number of policy measures, such as playing the West against the East in the cold war. These interactions were strengthened in the form of North-South relations in the course of the 1960s, mainly by the creation of United Nations Conference on Trade and Development (UNCTAD) in 1964. The reality of the North-South relations were West versus South plus East.

The pressures of North-South negotiations on the Western donors, however, were not felt strongly in the 1960s. In fact, ODA from Development Assistance Committee (DAC) countries began to decline from 1967, a trend which prompted the then President of the World Bank (George Woods) to form the Pearson Commission. This decline was mainly due to the disappearance of the factor related to the end of World War II and to the weakening of the immediate political requirements of decolonization. Since then, the major factor that constituted the political basis for ODA became the cold war. With the start of détente at the beginning of the 1970s, the Soviet Union had to develop new approaches to fight against the West. From the viewpoint of the Soviet Union, it was difficult to compete with the West in such areas as finance and science and technology. However, in the area of commodities where the Soviet Union was the larger producer, including oil, it thought that competition was possible. It was the cold war that had to be relied on from the viewpoint of developing countries. Against this background, starting with the first oil shock of 1973, developing countries wielded commodity powers in the 1970s and applied pressure on Western countries through the North-South negotiations. The maximum impact of the North-South dialogue on the West was indeed felt in the 1970s. Instead of yielding on a New International Economic Order (NIEO), the West put emphasis on the Basic Human Needs (BHN) approach in its aid activities. The more demand for NIEO through North-South negotiations, the more BHN — this was the formula of the 1970s.

Structural adjustment

The NIEO and the BHN approaches had a common feature, which was to avoid policy adjustment at the macro level in developing countries. The dislocation of a large number of developing economies due mainly to two oil shocks brought about debt crises in these countries in the 1980s. By this time, political motivations of the donors began to be weakened. While the use of aid as a leverage for liberalization of individual developing countries was a new discovery on the part of donors, it was also felt by donors that the amount of development finance for this purpose did not have to be increased. The main immediate objectives of aid were to alleviate debt burdens and to promote structural adjustment, factors that were the negative impacts from development efforts of the previous decades. Forward-looking aid activities to promote economic development became a distinctly secondary consideration. Those developing countries that were developing rapidly, such as in Southeast Asia from the mid-1980s, should be, the donor community suggested, left to themselves (expect Japan, which continued its aid to most of these countries), meaning that they should be graduated from the aid recipient status.

End of the Cold War and a search for a new basis for development co-operation

Development co-operation lost its major political mandate with the disappearance of the cold war in 1989. Administrative inertia and leverage for liberalization kept aid programs going. Aid agencies began to look for their new political basis mainly at the DAC of the Organisation for Economic Co-operation and Development (OECD) in 1990 in the form of elaboration of the tasks of development co-operation for the 1990s that had been agreed in 1989. However, the overall volume of ODA started to decline in 1991. The search for a new basis for development co-operation pushed such concepts as ownership, participatory development and partnership, which had been discussed for some time in the academic circles, to the forefront on the political agenda. Combining these elements and selected targets from the various exercises in the United Nations context together, the New Strategy of DAC for the 21st century was adopted in 1996. However, these efforts failed to arrest the broad trend of decline of ODA, while there were certainly variations among donors, some of which, in fact, have been increasing ODA.

Globalization and development co-operation

The aid community began to find the new basis of ODA in the course of 1996-1997 — globalization. The major force that restructures the world community was beginning to be identified as the complex and powerful forces of market-based globalization in the mid-1990s. The G-7 Summit placed it at the centre of the agenda at its meeting in Lyon in 1996. Globalization has since then acquired political legitimacy. Other events, such as United Nations conferences in the 1990s, have come to be viewed as an integral part of the globalization process.

The Asian economic crisis that began in July 1997 was perceived to be a negative result of market-based globalization. Japan's response to it was to provide \$80 billion to the seriously affected Asian countries, while a large part of it was in the form and conditions of Other Official Flows (OOF).

The decline in ODA from Japan, which took place for the first time from 1996 to 1997, was arrested in 1998. While its future prospects are uncertain, the downward trend of Japan's ODA will not continue. It appears that the downward trend of ODA in major donor countries has largely been arrested. This is due to the gradually felt perception on the part of the donor countries that ODA might be a useful instrument to manage the now dominant forces of market-based globalization that is prevailing over the world community.

GLOBALIZATION AND THE SEARCH FOR A NEW POLITICAL MANDATE FOR DEVELOPMENT FINANCE

It is now increasingly clear that globalization forces are replacing the cold war as the predominant factor that dictates the basic structure of the world community. The relationship between the major powers cannot be described as adversarial any more, not because they have suddenly become friendly with each other, but because they cannot afford to have a major enemy at a time when they have to compete with each other vigorously. This competition has been brought about by the market forces that have been strengthened by financial market liberalization, development of financial instruments, trade liberalization and the information technology (IT) revolution. These forces go naturally beyond the relationship among major powers and now cover the entire world community. Just like at the time of the bipolar world, when development co-operation was based mainly on the logic of the cold war, it could find its new political mandate in relation to globalization in the coming period. Therefore, it is essential that the basic functions of globalization in the developing world are well understood and that a search for a new basis for development co-operation should be pursued in relation to these functions.

Two Tracks of Globalization

It is important to notice that the complex forces of globalization are gradually building two sets of alliances and structures. One has basically started as a process that promotes market forces in the world community. It is promoted mainly by world enterprises, the United States Government and such international organizations as the IMF, World Trade Organization (WTO) and the OECD. Other OECD countries selectively support this movement individually or through these organizations. This process can be described as market-based globalization, or a fast track globalization due to the rapidity of its impacts world-wide.

Another process of globalization is now gradually emerging and addresses itself mainly to the major problems that have been brought about or aggravated by the market-based globalization. These problems include poverty, environmental destruction and weakening of indigenous cultures. This globalization is promoted by civil society such as non-governmental organizations (NGOs), many United Nations agencies, the World Bank, bilateral aid agencies and many governments of the developing world. With the main objective of strengthening the public interventions either through governments, international organizations or civil society, this process of globalization could be called political economy globalization, or slow track globalization due to the time-consuming character of the alliance building among these major actors and of the impacts being felt in the developing countries.

The participation of NGOs became increasingly important in some United Nations conferences during the 1970s and the 1980s. The Rio Summit on Environment and Development was particularly instrumental in bringing NGOs into the mainstream at the global level as well as at a national level in a number of countries. One major outcome of the Rio Summit was the establishment of the Earth Council in 1993, networking some 20,000 NGOs globally at the initial period, and now expanding the membership more widely. One after another, successive United Nations conferences have had similar impacts on closer collaborations among United Nations agencies, developing country governments and NGOs. The World Bank, under the leadership of Mr. Wolfensohn, has gradually been integrated into this broad movement and now considers NGOs and United Nations agencies as its important partners.

In the meantime, the bilateral donors adopted at DAC the New Strategy of Development Co-operation in 1996, incorporating some of the work done by these United Nations agencies, in particular UNICEF. The G7 Summit has also endorsed this strategy, and bilateral donors put priority on social development and poorer developing countries themselves, in close co-operation with NGOs, United Nations agencies and the World Bank. The alliance of these actors is gradually becoming apparent and the slow track globalization is beginning to make itself felt in the global efforts for sustainable development. It is, therefore, essential to recognize the fact that two processes of globalization are at work, rather than one. The interactions between the two processes have already produced a range of new political regimes in Europe in the name of "a third way". The interactions between the two processes of globalization have just begun in the world community and this drama will become the dominant feature in the sustainable development discussions involving all the stakeholders.

Three Categories of Developing Countries

In the meantime, the impact of the fast track is indeed much faster than the other. The basic structure of the world community is largely influenced by market-based globalization, which is wielding decisive influences on developing countries. The term globalization is often used to mean this version of globalization, namely, market-based globalization only. Market globalism, in fact, has complex impacts on individual economies, and yet consists basically of two orientations that are opposite to each other. There are, on the one hand, powerful impacts on developing economies in the form of integration into the world economy mainly through private sector transactions, for example, trade, investment and finance, all of which are enhanced by the information revolution. The integrating forces that have been at work for the past two centuries have been strengthened considerably and the pace of integration has quickened for the past ten years.

On the other hand, market-based globalization has proved to be influential in marginalizing various segments of people and a number of countries in near totality. Domestic savings of poorer countries can be invested in industrialized economies for higher and surer returns through various channels. Graduates of colleges and universities can be employed by Northern institutions after considerable investment by poorer country governments in them. The traditional issue of brain drain is reaching a higher level as a problem. The downturn secular trend of commodity prices may be accelerated by higher efficiency of production that is being brought about by heightened competition globally. Thus, the marginalizing impacts of market-based globalization on poorer developing countries and poorer segments of people, mainly in developing countries, are already tangible in such forms as reverse flow of finance, brain exodus and commodity price declines.

At the same time, the marginalizing impacts can take a different form, which is to leave a number of poorer countries behind. Enhanced dynamism that has been promoted by market globalism concentrates private sector activities, such as trade, investment and finance, on efficient economies and in effect excludes inefficient and poor economies. Marginalization through neglect is in fact a powerful factor that is at work in the current world economy.

Therefore, marginalization impacts of market globalism, either through its concrete functions or by neglect, are important factors that influence the structure of the developing world.

The net impacts of the integrating forces and of marginalization that are associated with market globalism are to divide the developing world basically into three categories of countries: While some ambiguity is bound to exist, these consist of rapidly integrating economies, increasingly marginalized countries, and those countries where both forces of integration into the world economy and of marginalization from it are at work significantly at the same time.

Integrating economies

Private flows into developing economies virtually dried out in the early 1980s but resumed in the mid-1980s led by Japan's direct investment in Southeast Asian countries. By 1996, private flows were six times the volume of ODA (DAC, 1999, A1-2). These were concentrated in higher income developing countries (DAC, 1999, 48). The increase in the ratio of trade in global production continued in the 1990s, with the conclusion of the Uruguay Round in 1993 strengthening the liberalization process in trade world-wide.

Currency exchange and short-term financial transactions became dominant features in the international financial markets, which began to involve higher-income developing countries in the 1990s. In January 1998, the daily transactions of the global currency exchange were $1.2 trillion on average, equivalent to 20 per cent of world annual exports (Takahashi, 1998, 5). Therefore, currency exchange has become a market of its own. Short-term debt flows (defined as debt with original maturity of one year or less) to developing countries jumped from $19.5 in 1990 to $61.1 in 1995, while these were mostly to East Asian and Latin American countries (World Bank, 1999, 31-32).

Many of the Southeast Asian and Latin American economies, as well as such transition economies as Russia and Central European countries, were heavily influenced by all of these factors. The economic transactions on all of these fronts were dramatically quickened by the information technology revolution, in particular the international financial markets. The net impacts of these dramatically increased transactions in the private sector were to integrate these countries into the liberal global economic system. In the course of the first half of the 1990s, the positive aspects of this integration became a dominant feature, and optimism about market globalism was widely shared.

Integration of these economies, mainly through transactions in the private sector, can bring about two opposite consequences. On the one hand, rapid economic growth due to increased investment, incorporation of higher technology and enhanced competition can be its major outcome. While these were particularly predominant features in Southeast Asian economies in the first half of the 1990s, they could also be observed in some Latin American countries and Central European countries. The graduation of the aid recipient status for these countries was seriously discussed at DAC, resulting in the two tier structure of aid recipients. The high growth, however, was only one side of the coin.

The other side of integration into the world economy through enhanced transactions in the private sector was the collapse of these economies. Knowledge and information, which have universalistic qualities, are the important instruments of the management of market globalization. When faced with uncertainty with regard to the details of the socio-economic and political situations of these countries, the investors in these economies can quickly withdraw their investments in order to protect themselves at a small signal of adverse development in an economic, social or political sphere. Once some investors begin withdrawing their investment, others, who are equally uncertain about the economic, social or political developments in these countries, may most probably do the same. The chain reactions will easily undermine even the fundamentals of these economies, and may eventually lead them to collapse. The herd syndrome of short-term capital investment is as difficult to avoid as over-shooting in currency exchange rates. This was exactly what happened in East Asia from July to November 1997.

Marginalization of poorer countries

Marginalizing forces are powerfully at work in many African countries, some Central Asian countries and a few other Asian and Latin American economies. While there are a few positive market globalization phenomena that can be observed — between 6.2 to 7.4 per cent of FDI in developing countries was to low income countries during the period 1992 to 1998 (World Bank, 1999, 51) — these countries can be marginalized from the global economy in their entirety. Marginalization brings about low or even negative growth. This consequence has a highly dangerous implication when considered in the context of rapid urbanization which is proceeding at 5 per cent in Africa. The urban population is up-rooted from rural areas where different ethnic groups and tribes have a long tradition of living with each other without major conflicts. In cities, ethnic and tribal groups tend to live in separate neighbouring communities for purposes of socio-economic security. When economic downturns due to marginalization occur, these groups increase competition to obtain their share from a smaller economic "pie", leading occasionally to violent conflicts. The conflicts in the city can spread to their villages and eventually engulf a large part of the country. Where tribal or ethnic communities transcend national borders, this situation can be spread into a regional conflict.

At the time of colonialism, these were the countries that were exploited most by colonial masters. During the cold war, proxy wars were fought by some of them on behalf of the United States or the Soviet Union. With the onset of market globalism, these are again the countries that can be drawn into armed conflicts due to the marginalization impacts of this process.

Integration and marginalization at work simultaneously

In most major developing countries, integration forces into the world economy and marginalization impacts from market globalism are at work simultaneously. The modern sector of these countries can be attractive for investors from abroad, with a consequent expansion in external trade. The growth of this sector can be significantly higher than the rest of the economy. These countries include China, India, Pakistan, and Egypt, while Brazil is a borderline case between this category and the integrating group. Indonesia has slipped down from the integration category into this group. The sheer size of these countries makes it extremely difficult for the modern sector to raise the income levels of the entire economy through trickle down effects. The net impacts of market globalism on the rest of the country are to marginalize it even more than they have been before.

Consequently, the increasing gap between the rich and the poor becomes the major issue in these countries. With wider access to the mass-media, this increasing gap becomes a highly charged political issue. In democracies such as in India, the increasing income gap combined with the traditional social structure, such as caste systems, throws the elections into a boiling pot with consequent instability in the political leadership. In developmental authoritarian countries, this gap brings about a sense of uncertainty and complaints in a variety of forms. Social instability becomes a predominant feature in these economies.

The social basis of political leaders is inevitably weakened. The traditional approach of political leaders to this situation is to resort to various measures to strengthen nationalism. In the cases of India and Pakistan, nuclear explosions and ballistic missiles tests brought about tensions with each other, orienting the attention of the people to neighbouring countries in 1998. Mismanagement of this process can result in political confusions, including a military coup d'état, such as in Pakistan in 1999. In the case of China, the huge celebration of the 50th anniversary of the establishment of the People's Republic of China, with considerable elements of military display, enhanced nationalism. It is clear that one of the most important factors that will determine the quality of the world society in the first decades of the 21st century is the social stability of this category of developing countries.

Global Public Goods

Another major implication of the shift in major motivating forces that provide the basic structure to the world community from the cold war to globalization is the emergence of global public goods on a high order on the world political agenda. During the cold war, it was extremely difficult to conceptualize global public goods without any political implication. For example, knowledge, which is now considered widely to be a global public good, may have easily been interpreted as a political weapon favouring either the West or the East. However, the broad positive reactions to *Global Public Goods* (Kaul, Grunberg and Stern, 1999) suggest that the very basis of the international community has shifted to the broader and more tolerant perspective that is brought about by globalization forces. This book examines a number of areas such as the environment, cultural heritage and peace as potential areas where the concept of global public goods could be applied. All of the ten areas that were explored in this book have been given affirmative answers by the authors. Indeed, there could be more areas where the concept of global public goods could usefully be applied for further international efforts.

The concept of global public goods as related to globalization provides a potentially fertile ground for future efforts. The elaboration of this concept should go beyond the question of subject areas that should be included, and should deal in particular with institutional issues. Starting with the classic examination of inter-governmental organizational issues, new and important factors such as second track activities, global networks on a number of specific issues and informal personal linkages, as well as the corresponding domestic structures of government, civil society and others, need to be looked into. It should be essential to compare *Our Global Neighbourhood* (Commission on Global Governance, 1995) with *Global Public Goods* and elaborate upon institutional questions based on the concept of global public goods.

Policy Measures

In considering measures to be taken towards the three categories of developing countries and global public goods, the most important starting point is to strengthen the slow track globalization. Centring around the processes and the outcomes of the major United Nations Conferences of the 1990s, the co-operation among civil society, United Nations agencies, the World Bank, bilateral aid agencies and governments of developing countries should be enhanced. The major components of the ideas and objectives for this purpose are set out in the declarations and action plans that were adopted by these conferences. While some of them were incorporated into the DAC Strategy for the 21st century which was adopted in 1996, the key factors are much broader. While taking them into consideration, it is important to relate them to three categories of developing countries and to the concept of global public goods.

Policy measures towards the three categories of developing countries

(a) Integration countries

Policy measures towards these countries have to be considered in two separate cases, one of rapid growth phase and the other of a collapse of the economy. Development co-operation in these different cases requires different approaches.

Rapid growth. Major problems that are brought about by rapid growth as a consequence of integration into the world economy include environmental destruction, an expanding informal sector in the urban areas and weakened rural areas. While the government is aware of these problems, the collective mind-set of the leadership tends to be a single-minded pursuit of economic growth at the expense of these problems. It has also been discovered in the course of the recent Asian economic crisis that institution building in the country as a whole should be pursued in the rapid growth phase.

Collapse of the economy. In the face of the collapse of the economy, two sets of measures need to be pursued immediately. Firstly, a large amount of infusion of liquidity is an essential requirement. It may not have to be ODA, but it needs to be official finance due to the overwhelming requirement of stability. In the case of the recent economic crisis in East Asia, Japan provided $80 billion in official finance (over half of emergency finance that came from all over the world) with $5 billion in ODA and $75 billion in OOF such as export credits. This huge sum of official finance from Japan has contributed critically to the renewed confidence of the international financial community in these countries, except for Indonesia, which has until recently been beset with political problems. At the current level of confidence in international institutions on the part of major countries, it is virtually impossible to entrust a significantly larger amount of funds to them.

An alternative approach is to strengthen national institutions that are capable of delivering a large sum of liquidity. The establishment of the Japan Bank for International Co-operation (JBIC), which was created as a result of the merger between the Export-Import Bank of Japan and the Overseas Economic Co-operation Fund of Japan, is such an example. With an annual turnover of over $40 billion dollars combining ODA and OOF that have separate accounts, this new bank is expected to play a crisis management role in close co-operation with other institutions such as the IMF and the World Bank (Takahashi, 1999).

Secondly, environment protection activities and social sectors such as health and nutrition, primary education and food security need to be supported upon the collapse of the economy. It takes considerable investment and effort for a long time to build up systems for these sectors. And yet they are usually very vulnerable. It is essential for the donor community to support the efforts of the government, in particular officials in provincial authorities, in their struggle to maintain these systems that can easily become victims of the collapse of the economy.

While infusion of a large sum of liquidity and the support of environmental and social sectors require immediate action, it has also been recognized that institution building in such areas as financial and monetary systems and the general legal framework is also an important task.

(b) Marginalized countries

The first task is to re-conceptualize development strategies of many of these countries. The major ecological constraint for over 50 countries is lack of water. Therefore, the re-conceptualization for these countries has to be centred on this factor. Productivity in agriculture or in manufacturing has to be measured against the unit of water used. Public investment as well as measured privatization of public utilities has to have a clear priority on water whose multiple dimensions, namely, volume, quality and distribution, need to be addressed. It should be useful to organize a high level panel of experts to pursue this re-conceptualizing exercise at the world level with participation of experts from these countries.

Secondly, the targeted approach to poverty has to be a high priority. While it is always useful to combine it with a broad-based growth strategy, it may not always be possible to achieve a sufficient growth of, for example, five to six percentage points. Even in conditions with growth of one to two percentage points, poverty alleviation should have a high priority in these countries. The combination of rural development, including micro-financing, commodity based value added activities, and labour intensive industries need to be pursued as best suited to each country. However, in order to avoid any stigmatization from protective measures of well-defined groups, generic policy measures should be adopted as much as possible.

Thirdly, conflict prevention is an important consideration in many of these countries. The downturn of the economies due to marginalization from the world economy, often combined with rich natural resources, can trigger armed conflicts. These tend to take the form of tribal or ethnic conflicts, which are usually related to power struggles to control important natural resources. Since armed conflict is the worst enemy of the welfare of the people, the natural environment and development in general, it is of crucial importance to incorporate conflict prevention measures in aid for sustainable development for these countries. Inter-communal confidence building measures, fostering a culture of non-violence and stable control over natural resources are all important components of a conflict prevention package.

(c) Integration-marginalization countries

From the viewpoint of the stability of the world community at large, the prospects of the major developing countries, where integration forces and marginalization impacts of globalization are at work simultaneously, are the critically important factor. These countries have the potential to destabilize the international community as a whole. At the same time, they can be leaders in forging a globalized creative coalition of humanity towards sustainable development. The first major effort that is needed is to enhance measures to bridge the gap between the rich and the poor in these countries. The most important policy measure is to strengthen small- and medium-sized enterprises, in particular in labour intensive industries. One such industry, the textiles industry, has strong implications for the industrialized countries. For these priority activities, it is essential to include environmentally friendly measures and technologies.

The second policy area that requires particular attention is poverty alleviation. In most of these countries, poverty is closely associated with their social structures, whether in the form of castes or minority groups. Some targeted approaches towards these social groups are already in place. However, it is important to strengthen the policy measures that are friendly to the environment at the time when marginalizing forces are at work. Aid to sustainable development to supplement the efforts of the government both at the national and regional levels should play a critical role.

Thirdly, confidence-building measures between neighbouring countries should have a high priority. Joint projects across borders, such as joint management of international rivers, and even river basins are good examples. Joint protection of pristine tropical forests, such as those that are spread between Vietnam and Laos, is another. Aid to sustainable development for such projects should be a useful component.

Strengthening Global Public Goods

A major new challenge for the slow track globalization is to strengthen global public goods. This task is similar to the requirement of establishing good governance in individual countries. Global public goods provide a good basis upon which sustainable development efforts may be able to bring about favourable results globally. A large part of the efforts to strengthen global public goods, in fact, means institution-building in areas that are recognized to be global public goods. The forms of institution-building include traditional forms such as intergovernmental organizations as well as networks and informal arrangements. It all depends on the specific issue to be dealt with.

For these global efforts, the important task of aid to sustainable development is to strengthen the capacities of developing countries to participate in these efforts on a fair basis. This task has three dimensions, which are all related to the common factor, knowledge, that has become an even more important asset in the globalizing world than ever before. First, since global public goods are related to knowledge intensive activity areas such as the environment, culture and peace, it is essential for developing countries to strengthen the capacities of research institutions in these areas. The World Bank's recent efforts to create and strengthen the Global Development Network for the specific purpose of capacity building in research activities in developing countries are worth supporting from this viewpoint.

There are a number of other similar activities such as the Research and Capacity Building Network for African Development, which was launched in September 1999 as a follow-up to the Second Tokyo Conference on African Development. This research network is unique because it links Japanese and other Asian researchers with African research institutions for African development purposes; it will strengthen existing research networks such as the African Economic Research Consortium and the Council for the Development of Economic and Social Research in Africa and emerging research networks centred in Zimbabwe and the University of London. It has its own steering committee consisting of African and Asian, including Japanese, researchers; the global panel of experts and the secretariat is located in the International Development Research Institute of the Foundation for Advanced Studies on International Development in Tokyo, Japan.

The second dimension is the negotiation to establish and strengthen global public goods. It is essential for developing countries to build capacities to negotiate effectively so as to reflect their concerns in the formation of global public goods. While existing institutions such as those located in Geneva should continue their works, it would be useful to strengthen training institutions for each of the major issue areas. One area which is weak is environmental negotiation training.

The third dimension is management. Traditionally, cities such as Washington D.C., New York, Geneva, Paris or Vienna are centres for managing international agencies; the brain drain, which is associated with relocating managers to these cities, has been a major concern. However, global public goods are being managed increasingly through electronic networks and new managers may not have to move away from where they are. They could pursue local tasks and global management at the same time. However, for this to be realized, training of a certain number of competent people in the management of global public goods is an important requirement. This is an area of activity where major universities and training facilities in global corporations may usefully cooperate with each other to fill the gap. Development co-operation financing may help with bridging this gap.

EMERGING STRUCTURE OF FINANCING SUSTAINABLE DEVELOPMENT

Thus, globalization forces are bringing about a significantly different world from the time when the cold war prevailed. The reality of development finance has also been changing rapidly. It is important to examine the emerging structure of sustainable development finance against the background of the new global reality where globalization forces shape the global socio-economic structure. It is not useful to continue to look at sustainable development finance activities through the old, and increasingly irrelevant, prism of the cold war. While there are a number of new elements of sustainable development finance that can be discerned, the following six points are significant:

- the shift from the dominance of ODA to private sector centred financial flows;

- the declining trend of ODA;
- the disappearing non-DAC ODA;
- the potential emergence of new donors;
- the increasing importance of Other Official Flows (OOF); and
- new actors and mechanics.

From ODA Dominance to Private Sector Centred Financial Flows

The concept of development aid itself is a relatively new idea in the history of the world community, dating back only to the late 1940s. ODA as defined by the DAC of the OECD has only a three-decade history. In the course of the 1950s and the 1960s, when official aid was rapidly institutionalized, the international financial system did not have an adequate capital basis to finance the increasing needs of the newly independent countries through voluntary and private transactions. Therefore, official aid through the tax money in those countries that could afford to extend it and that had political motivations had to play a major role. The cold war forced competition between the United States and the Soviet Union, which extended aid mainly to neighbouring and strategic countries such as China in the 1950s. Through the 1980s, while there were a few times when private flows played significant roles in development finance, such as in the late 1970s for the recycling of oil money and in the latter half of 1980s when surplus savings of Japan were invested in Southeast Asian countries, the dominant feature of development finance was the importance of ODA.

However, capital market liberalization in an increasing number of countries in the 1980s and the 1990s has brought about a totally different structure in development finance. In 1997, financial flows to developing countries with per capita GNP of $3036 and above (in 1995, Atlas basis), in the form of ODA and OOF disbursement was $10 billion, in comparison to over $120 billion in private flows (OECD, 1998, 48). While there can naturally be fluctuations, the broad historical trend is the increasing importance of private flows to developing countries, in particular to higher income developing countries.

Declining Trend of ODA

The volume of ODA has constantly been an important issue in the international community, in particular in the DAC circle. The donor community began to be organized initially in relation to the question of aid volume. In the late 1950s, the major Western donor, the United States, suffered from significant balance of payment deficits and sought the co-operation of partners of the Western Alliance to share the burden of development aid. The Development Assistance Group (DAG) of the Organization of European Economic Co-operation (OEEC, originally a recipient body of the Marshall Plan), which soon became the Development Assistance Committee of OECD in 1961, was created to pursue burden sharing of development aid. While there have been ups and downs in intensity, aid volume has always been a priority on its agenda. Through various means, including the peer review mechanism, DAC has attempted to increase ODA for these last four decades.

The actual performance of ODA disbursement has largely been characterized by stability. While aid fatigue began to be mentioned already in the 1960s, the secular trend of DAC countries as a whole maintained an upward one through the 1970s (with the exception of the period between 1967-1971, the first episode of a downward trend). The 1980s and the early years of the 1990s were characterized by the maintenance of roughly the same levels of ODA from DAC countries.

The declining trend of ODA from these countries began in 1995, although some of them (such as the United States and Germany) began this trend immediately after the end of the cold war. Once ODA is established on a proper political basis (such as the cold war or globalization), it appears that the factors which are most closely associated with the trends of ODA performance are the inter-linked elements of Gini coefficients and the intentions of political leaders. Increasing gaps between the rich and the poor make it difficult for the government of the donor country to persuade taxpayers to maintain the ODA program. Increasing emphasis on market operations in OECD countries, which has brought about increasing rich-poor gaps in some of these countries, has contributed to a decline in ODA. This applies to such major donors as the United States and Germany, and later to Japan. In those donor countries where the levels of Gini coefficients were maintained in the 1990s, ODA performance has not declined.

It is encouraging to note that there are indications that the Gini coefficients may be improving in an increasing number of DAC countries. In Europe, through the broad wave of the third way governments, social policies are being strengthened. The rich-poor gap in the United States has reversed the trend in the mid-1990s, and is now beginning to be narrowed. In these countries, it can be expected that ODA performance is likely to improve in the coming period.

However, in some other major donor countries such as Germany and Japan, the Gini co-efficient performance may not improve in the near future. Therefore, it may be difficult for these countries to increase ODA in any significant measure.

While it is admittedly too simplistic to rely solely on Gini co-efficient performance to examine ODA trends, it reflects such parameters as government intentions and fiscal realities. Therefore, it can be a useful indicator which may precede ODA performance. Traditionally, there have been other important factors that have some influence on ODA volume performance. These include balance of payments performance and strategic considerations. In the case of new donors, export opportunities have also played a role in the initial stages, as, for example, in Japan during the 1950s and the 1960s. Therefore, it is important to include all of these factors in addition to the Gini co-efficient to examine ODA performance of individual donor countries. However, the broad indication of ODA levels that is given by the Gini co-efficient can perhaps play a more reliable role at a time when strategic considerations have become less important than during the cold war, and DAC members have gone far beyond new donor situations.

Overall, taking into account the encouraging signs of improved Gini coefficients in a number of European countries and the United States, and disquieting indications in such countries as Japan and Germany, the indications are that the net DAC flows of ODA will be maintained in broad terms at the present levels. In other words, the declining trend will stop in the near future, but any significant improvement cannot be expected.

Disappearing Non-DAC Aid

"Eastern" aid

The aid programmes of the Soviet Union and other countries of the "East" grew rapidly in the early 1950s, reaching close to 30 per cent of the level of the United States. These aid programmes also expanded rapidly in the late 1960s when DAC performance declined, in particular from 1967 to 1970. From the late 1960s to the early 1970s, the "Eastern" aid expanded three times, to reach about $3 billion in 1972 (OECD, 1973,153). These two periods coincided with the Korean War and the Vietnam War, where a large part of aid was provided to North Korea and China in the early 1950s, and to North Vietnam from the late 1960s to the early 1970s. Since then, the level of "Eastern" aid has stabilized and their ratio to DAC aid was around 3 per cent through the 1980s. In the 1990s, it disappeared almost completely.

OPEC aid

Aid programs of the OPEC countries expanded rapidly in the 1970s, led by Kuwait and Saudi Arabia. They peaked in 1980 at about 10 per cent of DAC performance, the year of the second oil shock (OECD, 1986, 78). With the broad declining trend of aid from OPEC since then, and with one country after another disappearing from the donor community, the aid programmes of Saudi Arabia and Kuwait are still continuing, but at substantially lower levels than before. Their combined aid in 1997 was just above one per cent of that of DAC countries (OECD, 1999, 86).

The aid performance of OPEC countries has been largely in parallel with the level of real oil prices. Therefore, there is a measure of uncertainty about the prospects of these aid programmes. However, it may be difficult to expect any significant increase in their aid delivery in the coming period.

Emergence of New Donors

While "Eastern" aid disappeared and OPEC aid diminished in the 1990s, some new donors have emerged. While still in their early stages and at low levels, aid programmes of the Republic of Korea, Taiwan, Province of China, Turkey, Singapore, Thailand, Malaysia, Indonesia and India have emerged on the development co-operation scene (OECD, 1999, 86). Most of these countries belong to the integration category in the developing world and are bound to go through the swings between rapid growth and the collapse of their economies. Therefore, their aid programmes are also likely to follow a similar pattern. The rest belong to the category characterized by the widening gap between the rich and the poor, and it is not likely that their aid programmes will expand in any significant way. The Gini co-efficient should be relevant in these countries also.

Therefore, while we may expect some increase in total aid volume due to the emergence of new donors, we cannot foresee a situation where they can replace the "Eastern" and OPEC aid programmes in terms of volume for some time to come. However, in the longer run, some of these new donors, as well as hopefully some others, may become important donors.

Other Official Flows as a Crisis Management Instrument

A major lesson from the East Asian economic crisis that started in July 1997 is that external official finance plays an important role in stabilizing the financial situation of the crisis economy and that a large sum is required for this purpose. While ODA is an important component in this operation, OOF, such as export credits and export insurance, play a critical role. In addition to IMF credits and IBRD loans, both of which are OOFs, the large amount of official finance from donor government sources have been proven to play critically important roles in the management of the East Asian Economic crisis.

Given the limited confidence of major economies in the international community, it is not likely that any significant increase of funds could be entrusted to the international institutions. It is then important for these major countries to develop bilateral mechanisms that can play these roles in the event of an economic crisis that will most likely be repeated in the integration category of developing countries. While the Japan Bank for International Co-operation (JBIC), which started its operation on October 1, 1999, was born out of the marriage of convenience between the Export-Import Bank of Japan and the

Overseas Economic Co-operation Fund (OECF), the need for this type of national institution as a crisis management instrument is obvious. While its current obsession is to safeguard the purity of the ODA components (OECF), it is essential that a new concept should be given to this bank. The categorization of different financial instruments such as ODA, OOF and Private Flows that was made 30 years ago may need to be reviewed in light of the totally new politico-economic environment which is largely dictated by the two tracks of globalization.

New Actors and Mechanisms

The world community has been testing a number of mechanisms for international development purposes and a number of new actors have emerged. Some of these developments seem to be of value in the coming period.

Support of South-South co-operation

While Economic Co-operation among Developing Countries (ECDC) has a history of some three decades, it has not been particularly effective in promoting sustainable development directly. Its major function has been to strengthen solidarity among developing countries for North-South negotiation/dialogue purposes. However, some donors have begun to support South-South co-operation in recent years. While there are no statistics for these activities, some of these activities have been institutionalized. In particular, the Asia-Pacific Economic Co-operation (APEC) has been gradually strengthening economic and technical co-operation among developing countries with the support of industrialized members in the name of "Partners for Progress". Another example of institutionalization is the support of Asia-Africa co-operation by Japan as follow-up activities of the Tokyo Conference for African Development (1993 and 1998). The highly relevant experiences of developing countries for their peers who are being supported by traditional donors are proving to be a useful addition to the instruments of international development.

Micro-finance

Micro-finance has become a popular subject in development finance in the past 10 years, while it has been practiced in various forms for the past several decades. Its positive impacts, further potential, as well as its limits, have been examined extensively. It has been pointed out that since its operations have such small impacts nation-wide, its influence on macro-economic performance is negligible. One direction where a breakthrough is being sought is to link micro-finance operations with formal financial institutions which are linked with the global financial market; this is an option which requires careful protection of micro-finance institutions and its beneficiaries.

With these limits and cautions in mind, however, micro-finance has been useful in mobilizing domestic savings and international development funds for the purposes of empowering the poor, in particular, the rural poor. It is important to maintain the current broad practice where domestic savings and, thus, domestic finances play the central role, to which external finance is added. Ownership of the local community is an essential requirement for success in micro-finance operations. International NGOs can play even more important roles in mobilizing external resources to support these operations. There may be more scope for ODA to contribute to these operations. There is a possibility that there may be an increase in external resources from business, NGOs and ODA that might be realized, but the amount involved will not be significant.

Non-governmental Organizations

The important roles that civil society organizations, in particular NGOs, play in sustainable development have been confirmed for over a quarter of a century. In the context of the Basic Human Needs Approach, which the donor community adopted as its common perception in the mid-1970s, the critical roles the NGOs had been playing were recognized as an essential component of international development. After having played central roles in major United Nations conferences during the 1990s, their financial contributions had been expected to increase.

However, the financial contributions of NGOs to sustainable development purposes from 1990 to 1997 have been largely at the same levels, ranging between 4.6 - 6.0 per cent of total flows (OECD, 1999, A2). In fact, this ratio has been decreasing slightly since 1995. It appears that while ODA performance is closely linked with Gini coefficients and the political will of the leadership of the country, NGO performance is more closely associated with GDP growth. While this observation requires close examination, the broad historical trend suggests a critical linkage between the two. If this linkage is maintained in the future, financial contributions from NGOs will increase, but at a moderate pace.

The emerging structure of sustainable development finance consists of the following components. By far, the largest component is the private finance which is mainly targeted at higher income developing countries. ODA is decreasing slightly, but is practically the predominant element in external finance for poorer developing countries. “Eastern” ODA has disappeared and OPEC aid is decreasing rapidly. There are some new and potential donors on the horizon, mostly in East Asia. However, their financial contributions will be rather limited in the coming five to ten years' time.

One major factor which has proven to be critically important is OOF, at a time of financial crisis in higher income developing countries. A stable and large source of finance being the essential requirement in such a situation, OOF is the most important instrument from among those that are available.

Some new mechanisms and approaches, including support of South-South co-operation by donors, micro-finance and civil society, have positive impacts. However, their contributions are likely to be limited in terms of the volume of additional finance that can be mobilized.

PHASE ONE: GRADUAL STRENGTHENING OF SUSTAINABLE DEVELOPMENT FINANCE

It is now clear that the political mandate for international development finance is related to the management of both fast and slow globalization processes. The world community faces four important tasks:

- to adjust fast track globalization to the needs of developing countries;
- to strengthen the slow track alliance;
- to develop differentiated strategies towards three categories of developing countries; and
- to articulate ways to build up global public goods.

International financial contributions to sustainable development have to be strengthened along these lines. Over time, interactions between the two tracks of globalization will bring about a new basis for global co-operation. The important task of the first phase is to shift the gears of the world community gradually so that these four objectives can be pursued in a positive and realistic manner. For this purpose, the following six considerations should be useful.

Involvement of Private Finance and OOF in Sustainable Development Consultations

The predominant financial contributions to higher income developing countries are being made from the private sector and it is important to devise mechanisms where foreign direct investors, banks and other actors in the private sector are brought into a consultation process on sustainable development. Manufacturers and retailers have been sensitized to various requirements for environmental concerns, but they have not been exposed to the discussions and consultations on broader dimensions of sustainable development, such as governance and social development. The financial sector has not been sensitized to any of these requirements sufficiently and it is essential for the world community to develop a system where private financial actors are involved in the consultations on sustainable development.

Agents of OOF such as Export-Import Banks, trade insurance agencies, Central Banks and others are not any better informed than private financing actors with regard to their level of sensitivity to sustainable development. Given that their involvement in economic crisis management in higher income developing countries is of critical importance, and that the consideration of sustainable development in devising a recovery package is a crucial requirement, these institutions need to be sensitized to key dimensions of sustainable development. They, therefore, should also be involved in the consultation process on sustainable development.

While involvement in consultations does not guarantee an immediate positive shift in behaviour, it is difficult to expect their contributions to sustainable development to change in any significant manner without their involvement in these consultations. One approach to the private sector and OOF may be to organize informal meetings back to back with the existing sessions of the United Nations Commission on Sustainable Development and the World Bank's Aid Group Meetings. Starting with the World Business Council on Sustainable Development, other major business groups and OOF agencies may be invited to these meetings. At a time when restructuring is taking place in private financial institutions and OOF agencies, it should be more effective than in the past to incorporate new considerations in their activities. One should not underestimate the importance of involvement in the consultation process at a time of setting new priorities.

Decentralization and ODA

It is essential for the declining ODA levels to be placed in a new domestic context in both donor and recipient partners. This new context is decentralization, giving increasing power to local authorities. It is important to pursue this for two reasons: One is to look for ways to enhance relevance of development co-operation to tax payers and beneficiaries; the other is to bring the environment, governance and social development closer to where they are dealt with.

The question of relevance is the starting point of ownership. It applies to donors as well as to recipients, whose dimension tends to be the major concern in recent policy discussions. However, it is clear that the ownership of tax payers is also an important dimension in order to reverse the declining trend of ODA. In order to enhance the sense of ownership of tax payers in donor countries, the most important approach should be to bring local authorities into development co-operation activities more closely, in particular at a time when decentralization is a high priority on the political agenda of many donor countries.

Tax payers tend to be more open-minded and more sympathetic to development co-operation than anticipated, an attitude which is often revealed in opinion polls in donor countries and their sensitivities should be brought to bear upon the issue of ODA.

In recipient countries, there are also some indications of decentralization. While decentralization cannot be a panacea for all the ills of the central government, it is bringing about a new situation where local authorities are becoming potentially important partners in development co-operation. The participation of local authorities in development co-operation, in areas where actions take place, should enhance ownership of the beneficiaries. The capacity building of local authorities is an urgent task for aid to sustainable development.

The second reason is related to the fact that a number of important factors for sustainable development such as water, sewage and education are largely administered by local authorities. On the part of donors, it is mainly the local authorities that can provide know-how in these areas. And on the part of recipient countries, local authorities are the ones that need to be empowered in these areas. Therefore, on both sides of the development co-operation partnership, the involvement of local authorities should be an important component for effective actions.

Thus, the decentralization of donors and recipients requires the increasing participation of local authorities. It will strengthen the basis and operations of sustainable development co-operation, contributing inevitably to the enhancement of financing for sustainable development. A typical example is the environmental co-operation between Daireng of China and Kitakyushu of Japan, which initiated the operation that is now supported by the governments of both countries. There is significant benefit from this approach.

Importance of Less Co-ordination

For almost three decades it has been fashionable to advocate the importance of aid co-ordination. Recent practice places emphasis on sectoral co-ordination in recipient capitals. The avoidance of duplication, mutual enhancement and efficient use of scarce resources have always been the objectives of aid co-ordination. In addition, alleviating the burden of too many donors on a recipient country has often been mentioned. There can be many more reasons why aid co-ordination should be desirable. However, aid co-ordination in reality has rarely been effective, and it has been time-consuming and labour-intensive and sometimes highly expensive.

It is time to consider an approach where aid co-ordination in recipient capitals is limited to a few sectors that will really enhance the efficiency and effectiveness of aid. The concentration of co-ordination efforts in these highly selective areas may enhance the utility of these efforts, while less co-ordination of donors in other areas may often contribute to ownership by recipient countries.

Closer Consultations with New Donors

In the initial period, donors tend to be motivated either by politico-strategic considerations and/or commercial gains. In the process of mutual interactions, such as peer reviews by DAC, donors have become mature, looking for ways to maximize contributions to the broad-based development of recipient countries, and at the same time fostering the concerns and interests of tax payers in donor countries themselves. This is a constant learning process.

It is essential for the donor community to invite emerging donors such as Malaysia and Thailand, for example, which have reduced aid activities, hopefully temporarily, for the past two years due to their own economic problems, to the consultation process. It should be important for DAC to invite them to some of their meetings. These new donors are fully aware of the sensitivities of recipient countries, and DAC members may learn a lot from them as well. Mutual learning is the essence of this process, and new donors may reach the levels of maturity much more quickly than otherwise.

Support of South-South Co-operation

Another concrete way to enhance the activities of new donors is to support South-South co-operation. While OPEC donors provided financial support to Southern colleagues for, among other things, solidarity purposes, the new donors have started to extend technical co-operation in such areas as tropical agriculture and foreign direct investment. These activities often can be strengthened by financial support by Northern donors. One recent example is the establishment of a centre for information and training in Kuala Lumpur, Malaysia, for the purpose of business activities in Africa, with the support of Japan and France. These new donors can have a comparative advantage over traditional donors in technical co-operation on a number of grounds: appropriate technology, climate and geography, language, culture, region, cost or their own recent experience. The financial support of Northern donors for South-South co-operation will make these invaluable assets available more effectively than pure Technical Cooperation among Developing Countries (TCDC). Current efforts to learn from these new activities through such gatherings as the Okinawa Forum on support of South-South Co-operation which took place in May 1999 will contribute to the refinement of this formula.

Strengthening Global Public Goods

While debates on global public goods have failed to advance substantive discussions in the mid-1990s due to objections of some major countries, the recent publication of *Global Public Goods* (Kaul, Grunberg and Stern, 1999) has helped to promote this idea significantly. In some European capitals and in Japan, this policy idea is seriously treated. While aid is being broadly recognized as an integral part of foreign policy by practically all donor countries, the strengthening of global public goods is beginning to be perceived by some of them as an essential requirement of foreign policy.

In addition to well recognized areas such as environmental protection and the treatment of communicative diseases, new areas are being identified as global public goods, including knowledge and information. One recent example is the Global Development Network of the World Bank whose major objective is to strengthen the research capabilities of developing countries. The International Development Research Institute of the Foundation for Advanced Studies on International Development (FASID-IDRI) started a research network of East Asian countries in 1998, and began an annual publication of Trends and Issues in East Asia in 1999. It recently started an Afro-Asian network for research and training for African development in September 1999. Some other institutions have begun these activities on a project basis, including "Spreading Gains from Globalization" in Sussex University, which started in September 1999, and the University of Tokyo's project on globalization and structural adjustment, which commenced its work in November 1999. The gathering of OECD countries' research institutions on development may also begin to consider ways to contribute to capacity building of research institutes in developing countries in the near future.

These concrete activities have been helped considerably by the *World Development Report* (1998) which focused on the roles of knowledge for development, and *Global Public Goods* (1999), in particular its chapter on knowledge as a global public good by J. Stiglitz. It is important to establish and strengthen research capacities at the country level on a number of key areas for development such as governance, social policy, environment protection and growth. These institutions need not be large ones, and need to have only a few competent people, establish close networks with other institutions within the country and abroad that specialize in similar issues in order to contribute significantly to the sustainable development of the country. There is a strong disposition on the part of donors to support these efforts of developing countries. The accumulation of knowledge for development through these activities will soon be considerable. Through a number of networks, this knowledge will be widely shared, thus constituting a global public good. The past fifty years of experience with development efforts in the world community will be a major asset for the purpose of sustainable development.

By redoubling efforts on all these six fronts, it will be possible for the world community to reverse the downward trend of sustainable development finance. Any one area of these actions can be realistically implemented without causing prohibitive political difficulty. It should be important to begin efforts to provide the world community with new vigour and energy on this basis. While all of these efforts may not increase development finance significantly, the totality of them will begin to change the political atmosphere where a new culture of international co-operation will become an important feature in the world community. By putting together these efforts with new gains by developing countries through such means as workers' remittances and exports that are made available by market based globalization, the politico-economic environment for sustainable environment will improve significantly.

PHASE TWO: RE-CONCEPTUALIZING COOPERATION FOR SUSTAINABLE DEVELOPMENT

By pursuing these six lines of activities, development co-operation may be able to establish itself as an important pillar for the management of globalization. It is expected that slow track globalization will be strengthened considerably and that the interactions between the fast and slow tracks will begin to find themselves to be mutually complementary to a considerable extent. If we succeed in taking Phase One now, the initial years of the 21st century will be characterized by a search for a following major phase to strengthen co-operation for sustainable development. Barring a disaster scenario, of which there could be many, the Second Phase will require a significantly different approach from the one with which we are accustomed. The major components of the Second Phase will consist of the following:

- the pursuit of policy coherence;
- the global involvement of the private sector;
- the increased roles of civil society;
- the central role of global public goods; and
- the charging of fees for the use of common goods.

Pursuit of Policy Coherence

The incoherence of policies of donor governments has been an important issue since the publication in 1969 of *Partnership for Development*, also called the *Pearson Report*. Although it has been discussed at various fora of the OECD since then, with some emphasis on it in recent years, there has not been any significant progress.

However, with increased interactions between the fast and slow globalization processes, the incoherence of policies of donor countries will begin to affect their own economies negatively. For example, efforts to overcome an economic crisis in some higher income developing countries may entail the provision of a large amount of OOF at a time when tight fiscal and monetary policies may be pursued by the donor countries to contain, for example, inflationary forces. If the economies in crisis are not able to increase exports to these major markets, they may find it difficult to overcome the crisis. At higher levels of integration of economies, this situation will force increasing numbers of people to migrate to the donor countries, forcing donor governments to expand the budget to deal with various social issues that are brought about by the new migrant workers, either legal or illegal, thus increasing aggregate demand. The macroeconomic policies of donor governments will be, therefore, forced to cancel each other out in such an interdependent world. This sort of event, which unfortunately may not be a fantasy, will force donor governments, for their own sake, to consider the question of policy coherence towards developing countries more seriously than before. Development co-operation, which used to be largely a question of aid from the viewpoint of industrialized countries, with some consideration of trade, will come to be recognized as a broader issue, taking macroeconomic and sectoral policies into account, as well as aid, trade and investment policies. The need for an effective mechanism where research and consultation will be combined will be strongly felt by the international community.

Global Involvement of the Private Sector

While foreign direct investment in the marginalized category of developing countries is negligible in the present situation, it may well be an important factor in most of these countries with the progress of the First Phase. In addition to trade, investment linkages with the global market will expose these countries to opportunities as well as risks of the market economy. The major functions of ODA will have to be shifted towards support of the market mechanism, including the strengthening of safety-nets. By then, the experience of other developing countries with powerful forces of market globalism will be considerable and they will be in a position to provide know-how to deal with them from the viewpoint of developing countries.

Crisis management mechanisms will have to be strengthened considerably. It is expected that the confidence of major economies in the international community will be strengthened to some extent. However, the level of confidence may not be raised to such a height where global mechanisms such as the IMF will be significantly enhanced. Needless to say, a global central bank will continue to be a dream. Most probably, regional IMFs will be established. Co-ordination between the IMF, a regional mechanism and national instruments will become a difficult issue, although the multiplicity of these instruments will give a better choice of policies for developing countries.

Another important development is that actions in co-operation for sustainable development will need to be quick so that they support transactions of the private sector effectively all over the world. The bureaucratic structures that have been built up in the aid agencies in the past decades will need a major change. The broad trends of debureaucratization will be twofold. Firstly, programme officers, as opposed to administrators, will have to become a dominant feature in aid agencies. They will handle virtually everything by themselves within a given mandate. The second trend will be to entrust an increasing part of the aid operations to bodies and groups that are outside the aid agencies. They will combine research functions and NGO activities in some specific fields. By combining professional competence with the advantage of small sizes, they will be well suited to act quickly.

Increased Role of Civil Society

It is expected that civil society will play significantly more important roles globally in the Second Phase. Increased portions of ODA will be channelled through NGOs, but private contributions may continue to grow largely along the lines of GDP growth. Therefore, the balance between government contributions and fund raising from the private sources will be an important issue.

The increasing involvement of NGOs in co-operation for sustainable development should make it easier for political leaders to put emphasis on these activities. The strengthening of civil society and their increased involvement in the activities mean an increased potential for votes for ODA activities and NGOs themselves will increasingly become a basis for strengthening and expanding ODA.

However, the increasing roles of NGOs for ODA will inevitably strengthen the national characters of NGOs, leading, in some cases, to NGO nationalism. The one major advantage of NGOs is the ease with which they cross national borders and cultures, but NGO nationalism may undermine this. Within the NGO community, it is likely that NGO nationalism will become one major issue that will require thorough soul searching with regard to their identity.

Another factor that will become important is the relationship, in the developing economy, between NGOs and business firms that are based in the same donor country. The relationship between aid agencies and business firms has traditionally been a delicate issue in a recipient country, and the rules of the game have been established over time. NGOs that are increasingly supported by ODA and business firms, particularly in poorer countries, may have to develop a transparent relationship that is acceptable to the recipient country itself. It might become necessary for the international community to arrive at a set of principles that govern the relationship between them.

Central Roles of the Global Public Goods

It is estimated that about half of ODA expenditures is on various components of global public goods. However, these expenditures are not yet conceptualized as such. By the end of the First Phase, with a clearer notion of global public goods, it is expected that these will account for almost two thirds of ODA expenditures. The Second Phase may well be able to assume that the major objective of ODA will be to strengthen global public goods. It may become feasible to strengthen existing relevant facilities such as the Global Environment Facility and to establish new ones on a selective basis, such as a global facility for knowledge management for sustainable development. The objectives of the global knowledge facility may be to strengthen country based knowledge institutions and to act as a central stock-taking mechanism of knowledge and information that are gained by these institutions, and as an effective knowledge dissemination agency. It may be useful to link the institutional knowledge of global organizations such as the World Bank and UNDP as well as regional ones, such as the Asian Development Bank and the Asian Pacific Economic Cooperation, with this new facility for broader use by each developing country and by the world community as a whole.

An increasing number of components of environmental issues will be perceived to constitute global public goods/bads. Water, which has highly regional characteristics based on hydrological observations, may become a central component of environmental public goods to be protected. It may indeed become a high priority commodity globally. Biodiversity may by then require its own global facility due to the saliency of this issue. Each of these issues may be supported by their stake-holders who, in turn, may have built up constituencies due to a widely shared perception of their importance. Whether or not to reintegrate the multiplicity of these funds and facilities into GEF may become an issue.

Charging Fees on Use of Global Common Goods

It has become a common practice nationally to charge fees for the use of some common goods such as water. Globally, sea-bed extraction was an important negotiation issue in the 1970s. With regard to air, the Kyoto Protocol on Climate Change of 1997 made a major advancement on this question. It is not beyond realistic expectation that in the Second Phase, charging fees for the use of global common goods will begin on a selective basis. The Tobin tax may also begin to have some reality. These fees might become the basis of the multiplicity of global facilities which might also be so devised as to function as collecting agents of these fees.

Since the collection of fees will be made based on the use of common goods, the more use and consumption of these common goods means the payment of more fees. In effect, industrialized countries will pay these fees much more than others, although it is essential that the same rules should be applied globally.

In the initial stage of de facto global taxation, a number of unexpected problems may arise. At the same time, it should be important to analyze these experiences and to learn from the lessons in order to improve these mechanisms and practices on a global basis. Therefore, at this early stage of global taxation, it should be important to establish global research institutions to pursue these activities. Experts from around the world should jointly review these experiences rather than to let existing national research institutions and universities to pursue these tasks alone because the national level research may well supplement the efforts at the global level.

Given these five components, the Second Phase, which may come even before the year 2010, will require re-conceptualization of co-operation for sustainable development. The major task of policy intellectuals is to begin re-conceptualization work now so that the world community as a whole can start preparations for the Second Phase soon after the year 2002.

CONCLUDING OBSERVATIONS

It is essential, when considering financing for sustainable development, to avoid wishful thinking, on the one hand, and exercising too much technicality at this stage of policy debates, on the other. These approaches will not contribute to effective discussion and policy considerations. The most important requirements for presentation of a basis for policy discussions are threefold:

- to recognize that the political basis for development co-operation has shifted from the classic factors of management of the aftermath of World War II, of decolonization and of the cold war to the management of globalization;
- to observe that the private sector is becoming a predominant factor in higher income developing countries, whereas ODA, which is declining, continues to be an important feature for poorer developing countries; and
- to consider policy options in phases based on the reality of the politico-economy in the world community, with a first phase consisting of some advance on key instruments so that a declining

trend of ODA can be stopped and that positive factors can be built up, and with a second phase when a clearer advance is being attempted with the re-conceptualization of co-operation for sustainable development.

Concrete proposals and ideas have been made in section V for six areas during the First Phase which needs to be acted upon as quickly as possible. These are the measures that could be pursued without radical departures from what are being practiced now. For the Second Phase, policy proposals have been given for five areas. Some of these may sound rather too idealistic now. However, with the advance of the First Phase, they will become well within the range of realistic possibilities. Some may wish more idealistic options, which, however, may not be useful for policy debate at this juncture. All of these policy proposals put together will require a rather fundamental re-conceptualization, however, of co-operation for sustainable development. Intellectual efforts to pursue it should start now.■

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OFFICIAL DEVELOPMENT ASSISTANCE AND SUSTAINABLE DEVELOPMENT IN AFRICA: TOWARDS A NEW STRATEGY

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EXECUTIVE SUMMARY

Official development assistance (ODA) has played an important role in the development process and poverty alleviation in Africa since the end of World War II. The rationale for ODA was encapsulated in several theories, notably the donor-oriented theory or international relations theory and supplemental theories of foreign aid. At the United Nations Conference on Environment and Development (UNCED), held in Rio de Janeiro in 1992, it was emphasized that the implementation of Agenda 21 would entail large resources that could, in the short run, be out of the reach of many developing countries. Thus, in the spirit of international cooperation for development, the international community acquiesced on the need for increased ODA flows to developing countries, most of which are in Africa.

However, while the need for ODA has increased, the flow has declined and is characteristically unpredictable. The decline has had far-reaching adverse consequences for the promotion of realistic sustainable development in developing countries, including those in Africa. Hence, the fundamental questions are what went wrong and what must be done to arrest and reverse the decline in foreign aid flows, particularly to Africa?

Thus far, although the level of implementation varies from one country to another in the continent, some common areas of implementation of Agenda 21 may be identified. At the national level, these include the integration of Agenda 21 measures into national economic policies, strengthening of environmental laws and creating them where they do not exist. There have been actions in the consolidation or creation of environment institutions. Other actions relate to environment impact assessments and capacity building. In regional actions, intergovernmental organizations have begun to take a leading role in the co-ordination of regional environment programmes. On the substantive issues, the questions relating to natural resources management, poverty, population, human settlements, health and waste and hazardous materials are currently receiving attention. At the international level, co-operation between the United Nations' organizations and the World Bank has increased for the implementation of freshwater and food security measures in developing countries. The Global Environmental Facility (GEF) as made some contributions in the financing of projects in biodiversity, climate change, international waters and the prevention of ozone layer depletion. And more importantly, the United Nations Development Programme's Capacity 21 Programme is intended to promote capacity building in developing countries.

Progress in sustainable development in Africa has not been substantial because of enormous difficulties encountered at all levels of implementation. The forces emanating from the weak socio-economic structures of African countries and the international economic environment have acted as impediments to progress. At the national level, progress in sustainable development is hindered by the shortage of skilled staff, paucity of training facilities, lack of integration and co-operation among institutions, inadequate information, incomplete integration of all stakeholders into sustainable development programmes and counter-productive government programmes. At the regional level, sustainable development has experienced difficulties as a result of duplication of efforts and waste of scarce resources. There is lack of commitment by countries to full participation in regional initiatives. Also, the lack of financial resources poses serious difficulties to the implementation of programmes. At the international level, the major difficulties include inadequate and unpredictable funding of programmes

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in African countries. Also, the disadvantages of African countries in the international economy have massively militated against sustainable development in Africa.

The decline in bilateral and multilateral ODA flows to Africa was due to the unfavourable circumstances emanating from the world economy, the developed countries and African countries. The collapse of the former Soviet Union and the emergence of new states increased demand for ODA from the developed countries and shifted attention away from Africa. In the 1990s, most developed countries were confronted with the need to reduce budgetary deficits at home. Along with this, the European Union countries were concerned with the agreement to reduce fiscal deficits as a condition to attain monetary integration during the decade. The 1990s were particularly a period of aid fatigue in the developed countries owing to perceived poor results in the utilization of aid in the continent. Aid utility has suffered from poor aid co-ordination and management. Furthermore, the political instability in some countries in the continent represented a serious setback to the advancement of sustainable development.

As it is today, African countries run the risk of losing the gains made in sustainable development because of the stated difficulties. ODA is critical to the implementation of sustainable development in Africa. It is important that new and more innovative methods are found to ensure increased flows to priority areas in sustainable development. In addressing these, actions need to be taken at all levels of implementation. At the national level, new methods of policy co-ordination are desirable to harmonies the interests of bilateral and multilateral donors. There is a need for more stringent laws and regulations to deter corruption and mismanagement of aid. The administrative, political and economic bottlenecks to full disbursement of allocated ODA should be identified and removed. African countries should get more involved in the creation of appropriate aid constituencies in the developed countries to lobby lawmakers to ensure increases in aid disbursements to Africa. Additionally, African countries should endeavour to improve their internal taxation systems to raise additional funds for sustainable development, especially for the creation of sustainable development institutions. At the regional level, regional development banks and intergovernmental organizations should assist in the generation of additional ODA to African countries.

However, the more enduring efforts would come from the international community. At this level, the way forward includes stronger political will in developed countries to commit more aid for sustainable development, the need to disburse aid on a timely basis, the reduction of aid tying and the channelling of aid to priority areas of sustainable development as identified by African countries. Above all, the international community should take appropriate steps to remove the obstacles to the external trade of African countries in order to enhance their autonomous base for the long term financing of sustainable development. The multilateral agencies, especially those of the United Nations, are currently engaged in restructuring for greater effectiveness because of changing global circumstances. The international community should effectively fund these agencies to enhance their capacity to effectively deliver on sustainable development issues in Africa.

INTRODUCTION

THE United Nations Conference on Environment and Development (UNCED), held in Rio de Janeiro in 1992, was a turning point in the global approach to development. The Summit ended with a blueprint, Agenda 21, which globally addressed the question of sustainable development. Agenda 21 requires all countries to embark on a new development process that will preserve nature, the environment and resources for mankind and its future generations. At the same time, it was clear that these endeavours, which are critical to better the future of mankind, would require large resources for their implementation and could, in the short run, be out of reach of many developing countries. Thus, it was immediately clear that, in the spirit of international cooperation for development, official development assistance (ODA) would be needed in the case of the developing countries, most of which are in Africa. Chapter 2, Section 2.3(c) called on the international community to provide adequate financial resources to developing countries in order to achieve global sustainable development.

Traditionally, ODA has played, since the end of the Second World War, an important part in the process of development in many developing countries, including those in Africa. The termination of colonial rule in many countries called for some forms of financial support to promote the process of economic growth and to alleviate poverty. In this context, the flows of ODA to developing countries from the developed countries vary in volume over time to development targets essentially determined by the developed countries. Subsequently, the rationale for ODA to developing countries was encapsulated in several theories, notably the donor-oriented theory or the international relations theory and supplemental theories of foreign aid.

The main thrust of the donor-oriented theory stipulates that donors have other objectives besides the promotion of economic development in the developing countries. According to that theory, donors have political, strategic or economic interests in the disbursement of aid. The developing countries might be interested in long-term development and political stability with the hope of getting integrated into the world economy, on the principles of comparative advantage. But the developed countries do not perceive their own interests in these terms. For this reason, beginning with the 1960s foreign aid was thus generally directed at import substitution rather than export promotion. Along with this, there has been reluctance in the opening up of developed country markets to the industrial products from the developing countries. However, there have been major developments in the political, strategic and economic interests of the developed countries during the last three decades. It has become increasingly obvious that these factors may not represent credible and acceptable determinants for the flow of ODA in the face of new global trends characterized by partnerships for international development.

In contrast, the distinguishing feature of supplemental theories consists of its tenacious link to certain factors in economic growth. In the 1950s, this was broadly taken to be savings. The shortage of savings was considered a critical limiting factor to economic growth. However, in the 1960s, attention shifted to other factors, especially the need for foreign exchange and skills. But this notwithstanding, the influence of savings remained strong. It was argued that foreign aid could supplement savings and thereby enable the country to maintain the level of investment desirable for economic growth. The theory maintains that as the economy grows and incomes grow, the country can afford to set aside an increasing proportion of its income in the form of savings. Eventually, the economy will reach the point at which savings are sufficient to finance the volume of investment needed to maintain the desired state of economic growth without further requirements for foreign aid. In this thinking, supplemental theories are directed at the attainment of "self-sustaining growth." Self-sustaining growth was held out as a device and promise that foreign aid would be of limited duration. In other words, at a future date there might not be need for additional aid from the developed countries (White, 1974, 13-16). While this theory sounds realistic, it has been difficult to put into practice. For example, the ODA requirements for African countries to meet the development targets under the United Nations New Agenda for the Development of Africa in the 1990s were calculated, but disbursements have never been adequate and have generally remained unpredictable. Thus, this brings to the fore the question of the "political will" necessary to effectively support the growth process in Africa. On the whole, the limitations of both theories should be perceived further in the context of their capacity to address the broader issues of sustainable development. It follows, therefore, that a useful general theory on foreign aid will need to take into full consideration the parameters of sustainable development and the new thinking of the international community for international cooperation for development.

The idea of sustainable development emerged in 1972 out of deep concern over the threat to the natural environment posed by economic growth and industrial pollution at the United Nations Conference on the Human Environment in Stockholm, Sweden. Subsequently, the World Commission on Environment and Development (1987) published its report Our Common Future which attempted to explain "sustainable development" as an integrated approach to policy and decision-making in which environmental protection and long-term economic growth are seen as complementary and mutually dependent. It was noted that solving environmental problems required resources which only economic growth could provide. But economic growth will falter if human health and natural resources are damaged by environmental degradation. Thus, the report provided for an action plan that was issue-oriented on the question of pollution and non-renewable resource depletion (United Nations, 1997b, 2). In effect, the report set in motion the process that culminated in the convening of UNCED in 1992.

However, while the need for ODA has increased over the years, it is clear that the flow has declined and has been disappointingly unpredictable with far-reaching adverse consequences for the promotion of realistic sustainable development. This development has apparently created frustrations in many developing countries in Africa, particularly in those countries that strongly felt that most of the conditions required for increases in the inflows of ODA and other forms of foreign capital have been meritoriously fulfilled. For example, in the implementation of political and economic reforms, the establishment of democracy, good governance, accountability, structural adjustment programs, etc., ODA has declined when these countries have needed it most. Hence, the fundamental questions are what went wrong and what must be done to arrest and reverse the decline in foreign aid flows to the continent? The answers and explanations to these questions would definitely be found in a host of reasons. Some of these could be external or internal to the recipient African countries. In the light of the critical situations of African countries and other developing countries, several studies have been carried out on the issue of aid flows from the international community. The attempt in this study therefore will be to build on the existing body of knowledge in this area.

Five essential assumptions underlie this study.

Firstly, that in the present economic dispensation of many economically weak African countries, ODA is a sine qua non for the promotion of sustainable economic development and the realization of the goals of Agenda 21. Secondly, that an increase in ODA is possible in the future with improvements in aid utility; that is, with better results from existing assistance programs and projects. Thirdly, the flow of ODA to Africa could be conditioned less by adverse economic conditions in donor countries and more by other critical strategic and political world development issues that are of interest to the donor countries. Fourthly, that the flow of ODA could be conditioned by the dynamics of the world economy. Increased globalization engendering greater integration could foster increased ODA support for developing countries to develop and increase the demand for the products from the developed countries. Fifthly, sustainable development is attainable in Africa, but this will hinge on full and effective internalization of the measures of the programme in national policies and the creation of an appropriate enabling environment to nourish the programmes.

In this context, a five-point approach has been adopted for this study. The first section will provide an overview of sustainable development in Africa. It will attempt to describe development in Africa before Agenda 21. At the same time, it will present an account of the implementation of the programme in Africa since its adoption in 1992, highlighting the main encountered difficulties. The second section, entitled "ODA Flows to Africa," will relate the theory of foreign aid to its practice. It will describe the trend of both bilateral and multilateral ODA flows to Africa, addressing the origin, volume and destination of flows from 1979-1999. This period is inclusive of the period of reforms, the early and mid-1980s, and the period after the adoption of Agenda 21. The section will seek to explain the flows in the context of influential developments, both political and economic, in Africa, donor countries, and the international economy. The third section will further relate the theory of foreign aid to its practice through an in-depth critical analysis of some of the identified fundamental problems in the links between ODA and selected issues in sustainable development. The section will, inter alia, explore the rationale for aid decline, support for Africa's economic development, institutions, and capacity building. The fourth section will attempt to present a new road map to enhance ODA flows to Africa. In light of the observations from this study and the experience of ODA flows to other developing regions of the world, the chapter will seek to prescribe new and comprehensive policies and actions that will have to be undertaken by the recipient and donor countries and multilateral institutions to engender an increase in the inflow of ODA to Africa in the near future. In the final section, efforts will be made to draw strong conclusions from the main issues observed in the main body of the study. It will summarize the essential dynamics of ODA and the required collective efforts by all stakeholders in the promotion of sustainable development in Africa.

SUSTAINABLE DEVELOPMENT IN AFRICA: AN OVERVIEW

The developments in Africa, both political and economic, in the course of this decade have been far-reaching in the on-going transformation of the continent. These have, to a large extent, assisted in the shaping of the character and direction of sustainable development. At the same time, the quality and quantity of support that Agenda 21 received from the international community have dictated the rate of progress in sustainable development. Sustainable development is a priority matter for African governments because of its intricate linkage to poverty eradication. For this reason, there has never been a shortage of desire to implement Agenda 21 in Africa. But the enthusiasm to implement can be turned to reality only if the internal and external environments are right. Thus far, these environments cannot be construed to be absolutely right. The drive towards the achievement of sustainable development in Africa has not been impressive because a host of constraints have unduly impeded the implementation of programmes and projects.

Background

It will be noted that beginning with the early 1980s, African countries have acknowledged the necessity of political and economic reforms. Both were perceived as prerequisites for governments to fulfil their primary obligations of provision of improved welfare and the eradication of poverty. The initial actions of most governments were in economic reforms; that is, varying forms of structural adjustment programs to address economic recession and promote economic growth. But it became increasingly obvious that some of the existing political regimes — authoritarian or military regimes and one party states — were considered less helpful towards the promotion of a durable economic and political system. Thus, there were sub-regional and regional declarations on the promotion of democracy, good governance, accountability, human rights and the eradication of corruption.

This understanding led to the initiation of democratic processes in many African countries. Elections have been held in many African countries that hitherto were under military regimes or operated in the context of a one party arrangement. Political parties have been created in many countries to articulate political agendas for development. Along with this, the parliamentary process has been set in motion. Pressure groups, labour unions, non-governmental organizations, and the private sector now have more contributions and inputs into the process of governance. Furthermore, attempts have been made to create appropriate supportive administrative and legal institutions to buttress the democratic process.

The efforts of many African countries have been very significant in the promotion of democracy. However, it is clear that these arrangements are broadly in the embryonic stages. Democracy needs to be nurtured and sustained. The consolidation of democracy in the continent will continue to require more efforts from African governments to strengthen political structure, the political and administrative institutions as well as the legal environment. At the same time, increased technical and financial support of the international community would be needed to complement the efforts of African governments. While the democratic process has taken shape, in varying forms, in many countries, a few countries are, however, still confronted with critical internal political stresses and strains. For some of these countries, political stresses and strains have degenerated into civil wars with far-reaching consequences for their development. Also, these crises have had negative impacts on the development processes in the neighbouring countries and sub-region. Civil wars have resulted in the elimination of democratic governments and disruption of economies, infrastructure, and social systems. They have created an unprecedented volume of displaced persons and refugees. As has been noted in several studies, the crises in these countries have their causes in several factors that include colonial administration, history, deficiencies in political development, unequal economic development, poverty and ethnic strife, to mention a few. For these group of countries it is important to see to the immediate termination of hostilities. Efforts must be made for adequate post-conflict development, rehabilitation and reconstruction. African governments and the international community, including sub-regional and regional institutions, should give sufficient support to the countries in conflict to terminate conflicts and assist in bringing them to the path of sustainable development.

At the same time, it is equally imperative that efforts should be made to tackle the critical impediments to economic growth. It has been noticed that since the mid-1990s the continent has experienced a rise in many economic indicators. Real GDP growth accelerated to 4.5 per cent between 1995 and 1997, compared to an average annual rate of 1.5 per cent between 1990 and 1994. Real average per capita GDP growth became positive, at 1.1 per cent annually over the same period, compared to about negative 1.9 per cent during 1990-94. Also, export growth doubled from an annual average of 3.9 per cent between 1990 and 1994 to 7.8 per cent between 1995 and 1997 (UNECA, 1999, 8). It has been further observed that these improvements in Africa's economic performance have essentially been due to the positive effects of implemented macroeconomic policies by many countries beginning from the mid-1980s and better weather conditions, which led to increased export earnings. While this growth is fragile, it is clear that most countries are yet to get out of the woods of poverty. Hence, there is a need to maintain the momentum of growth and to increase efforts to eradicate poverty by addressing the fundamental impediments to economic growth and development.

Among other things, African countries need to mobilize domestic resources as a medium- to long-term goal. Savings rates in Africa have been low in the past. While savings performance varies between countries, African countries have lower savings and investment rates than other less developed countries. For example, in 1997 domestic savings as a percentage of GDP was 17.6 per cent, compared with 24 per cent for all developing countries in the same year. Also, investment was 18.3 per cent of GDP in contrast to the over 32 per cent required for the poverty reduction targets (UNECA, 1999, 21). As of 1994-96, the burden of external debt in the context of the ratio of total debt-service to export revenue of Sub-Saharan Africa was put at 30 per cent. Judged by the debt burden indicators and debt servicing capacity, it is clear that many African countries are still in serious debt problems notwithstanding previous debt relief extended by creditors. The burden of the external debt of African countries will need to be addressed further with an appropriate international debt strategy. Notwithstanding the notable efforts made by many African countries in the implementation of economic and financial reforms, FDI flows to most of them remain negligible. Africa trails other developing regions in attracting FDI. In 1994 it attracted 2.3 per cent of world FDI. This fell to 1.4 per cent in 1996 and to 1.2 per cent in 1997. During the same period, the flows to Latin America and the Caribbean rose from 11.8 per cent in 1994 to 14 per cent in 1997. Similarly, the flows to Central and Eastern Europe increased to 3.7 per cent in 1997 from 2.4 per cent in 1994 (UNCTAD, 1998, 9). Foreign direct investment will need to be increased in order to raise the level of productivity and facilitate economic growth and development.

The exports of African countries continue to remain insignificant in terms of total world exports. The impediments to Africa's external trade expansion continue to be manifested in both external and internal factors. In particular, the constraints to market access for African products in the markets of the developed countries should be removed to allow for a steady increase in African exports. The implications of the on-going globalization process should be considered and appropriate action taken to eliminate the marginalization of African countries. African countries themselves need to continue to adopt appropriate macroeconomic policies to reduce inflation, create more jobs and increase productivity.

Sustainable Development

Since Rio there have been actions at all levels concerning the relevant programmes of Agenda 21, especially in some basic priority areas such as institutions, policies, environmental laws, land, wastes and hazardous materials, population, human settlements and health and international cooperation and trade.

Institutions

Following the adoption of Agenda 21, the first obvious concern of African countries was the National Environment Action Plans (NEAPs) to address institutional mechanisms and organizational structures. In this context, countries have been implementing institutional reforms: national environmental institutions (ministries, departments, commissions, etc.), non-governmental organizations (NGOs), advocacy groups, and private-sector institutions have been strengthened or established to take responsibility for the environment and to promote sustainable development policies and programmes (UNEP, 1997, Chap. 3). Consequently, there has been increased cooperation between national agencies, responsible for economic planning, and those in charge of environmental management. Albeit, these institutions are still weak and inadequately equipped to implement their functions. These limitations stem from many factors, notably a serious shortage of skilled staff, the absence of adequate training facilities, lack of integration and cooperation among major institutions, and counterproductive government policies and legislation.

In the same vein, in order to support the implementation of the various General Assembly Resolutions on Agenda 21 follow-up, the Economic Commission for Africa Conference of Ministers Responsible for Social and Economic Planning and Development adopted, at its nineteenth session, resolution 757 (XVIII) through which it, inter alia, restructured the intergovernmental machinery of the Commission. Among the thematic Conferences of African Ministers responsible for Sustainable Development and Environment (CAMSDE), a committee of experts was also created to the Conference.[1]

There were also, at the international level, new initiatives with consequential institutional requirements, notably: the United Nations Convention to Combat Desertification, particularly in Africa; the Programme of Action for the Sustainable Development of Small Island Developing States; the Agreement for the Implementation of the Provisions of the United Nations Convention on the Law of the Sea of 10 December 1982, relating to the Conservation and Management of Straddling Fish Stocks and Highly Migratory Fish Stocks; and the Global Programme of Action on Protection of the Marine Environment from Land-Based Activities (United Nations, 1997a, 2). In addition, it will be noted that the Commission on Sustainable Development has initiated further institutional developments, characteristically the ad hoc open-ended Intergovernmental Panel on Forests (IPF). It has also reaffirmed arrangements directly relevant to its mandate, such as the Intergovernmental Forum on Chemical Safety (IFCS), established in 1994 to develop and review strategies for implementation of chapter 19 of Agenda 21. All these initiatives should provide support for the effective implementation of the conventions. But the growing number of conventions in environmental and socio-economic fields subsequently increased awareness of the necessity for linkages between the intergovernmental and support arrangements of the United Nations system and those of other organizations. Thus, international financial and technical support for the conventions has resulted in overall increased cooperation and new institutional arrangements between the United Nations system and international financial institutions.

Policies

The next important area of focus of most African countries has been the development of relevant policies. Efforts were energetically directed at the integration of the environment into key policies, plans and decision-making. This has entailed cooperation amongst various Government agencies and NGOs. Development in this area has been both innovative and encouraging. Some countries made special efforts aimed at integrating environmental protection and improvement activities into key sectors and chapters of their post-UNCED national development plans by ensuring, through inter-ministerial arrangements, the shared understanding and commitment of other key ministries. The broader participation of representatives and experts from major groups, such as NGOs, women and youth, was given a higher degree of attention which, in turn, led to public understanding and support. Several countries have established national youth bodies or held youth forums to improve consultation and programme delivery. Generally, typical programmes focus on leadership, environmental education, and community participation.

Thus, NGOs now play a significant role in raising awareness and mobilizing people at local, national, and international levels. Their interaction with government is regarded as helpful, and they are fre-

[1] The mandate of CAMSDE is based on the interrelationship between agriculture, with an emphasis on food supply, rural development, water resources, population, the environment and human settlements.

quently included as members of national sustainable development bodies and international delegations. At the same time, governments are encouraging sustainable development at the community level by strengthening the role of local government in environmental, natural resource, and infrastructure planning and development. Several African countries also took action on the over 25 proposals for integrating the environment and development in policies, planning and management in line with Chapter 8, Section A of Agenda 21. This was particularly the case in countries where (i) Agenda 21 plans were adopted; (ii) Agenda 21 national/sub-regional workshops were organized; (iii) Capacity 21 programmes of the United Nations Development Programme (UNDP) are being implemented. But the implementation of these policies will depend on the support of adequate environmental laws.

Environmental laws

After UNCED, African countries proceeded with the consolidation or creation of environmental laws. This essentially consisted of a major review and strengthening of existing laws by some African countries. In the context of Agenda 21 (Chapter 8), attempts were made to update and bring the laws in line with current scientific knowledge; reduce overlaps and conflicts; set much higher and tougher penalties to encourage compliance; clarify and harmonies the responsibilities of different ministries and levels of governments; and identify and fill significant gaps. In this connection, some UN agencies assisted in this exercise, for example through the implementation of the Government of the Netherlands funded joint United Nations Environment Programme (UNEP)/ UNDP (in cooperation with the World Bank, World Conservation Union (IUCN) and the Food and Agricultural Organization (FAO)) project on capacity building in the areas of environmental legislation and institutions. Thus, almost every country has established legislation or regulation that requires environmental impact assessments, especially at the project and programme level, but increasingly at the level of policy-making as well. Attempts are made to ensure that legislation is more specific. For example, the Mali Constitution of 1992 notes: "Every person has a right to a healthy environment. The protection and defence of the environment and the promotion of life are the duty of all and for the State." Some other countries whose constitutions also provide for environment, natural resources, and sustainable development are Ghana, Kenya, and Uganda. Additionally, the legal review by African countries also included relevant international conventions/agreements on the environment. In this regard, the African Ministerial Conference on the Environment (AMCEN) took commendable steps to encourage African countries to fulfil their main obligations under those conventions that they are party to. A good example in this connection is the African Ministerial Conference on the Environment (AMCEN) convened ministerial consultations (for Eastern and Southern African countries) on the sub-regional, regional, international and global conventions that took place in Nairobi, March 1995. This meeting identified other conventions which African countries should consider ratifying as a matter of priority. It is also noted that, in the case of the conventions on biological diversity and desertification, AMCEN, in cooperation with African governments, organizations, NGOs and relevant UN system partners, developed common perspectives and positions which guided and continue to inspire the region's participation in these conventions. The Organization of African Unity (OAU), in close collaboration with UNEP, Economic Commission for Africa (ECA), United Nations Office to Combat Desertification (UNSO), and other United Nations agencies active in the region, has been fully involved in mobilizing the effort in the negotiation for the United Nations Convention to Combat Desertification and support for its implementation, as well as other initiatives for the implementation of the Abuja Treaty establishing the African Economic Community. Some other programmes of action of AMCEN are shown in Box 1.

Capacity building

An important feature of both Agenda 21 and the African Common Position on Environment and Development is the strong emphasis on capacity building for sustainable development. In over 100 priority programme areas in Agenda 21, there are specific recommendations for capacity building. In response, several African countries, with the cooperation of bilateral aid agencies and UN agencies, have made national capacity building for sustainable development a high priority. The objective of the Agencies has been to assist African countries in the consolidation of their institutional, managerial and technical capacity to implement sustainable development programmes. For example, there is the UNEP Funded Regional Advisory Services project and the Government of the Netherlands funded \$5 million joint UNEP/UNDP project on capacity building (legislation and institutions). Also, the UNDP Capacity 21 Programme has been complementing the efforts of governments in this area. Additionally, UNDP has embarked on the recruitment of sustainable development advisors for some of its country offices.

Land

Under land issues actions were taken in a number of areas which include land systems, desertification and drought, land degradation, deforestation, water-related issues and coastal and marine areas. One fundamental fact in Africa is that traditional rights on land and access to land vary greatly from country to

Box 1. Important Programmes of Action adopted by the African Ministerial Conference on the Environment

- African Strategies for the Implementation of the United Nations Conference on Environment and Development, adopted by the Conference of Ministers of Economic Planning and Development at its 19th Session, 3-6 May 1993,
- Proposals for the Implementation of the Abuja Treaty Establishing the African Economic Community, the 14th Meeting of the Technical Preparatory Committee of the Whole, 12-16 April 1993, and the 28th Session of the Commission/19th Meeting of the Conference of the Ministers, 19-22 April 1993,
- Relaunching Africa's Economic and Social Development: the Cairo Agenda of Action, adopted at the Extraordinary Session of the OAU Council of Ministers on 28 March 1995, subsequently endorsed by the June 1995 Summit of the African Heads of State and Government in Addis Ababa, and
- The 1996-97 Programme of Work, adopted by AMCEN at its 6th Ministerial Session in Nairobi, 14-15 December 1995.

country. There are places where most land belongs to the state and places where they belong to traditional chiefs. Rights on land could facilitate access to land for small farmers or hinder it. The strong trend on the continent towards democracy and decentralization of civil powers is having a positive impact on land-ownership in rural areas.

The concept of giving back full authority to villagers for their land has gained ground. Within this development, the pilot villages of the AMCEN programme were successful, as illustrated in the case of Senegal. Also, many bilateral and multilateral donors and African Governments adopted this grassroots approach to land productivity, for example, Germany in Burkina Faso; the World bank, with Natural Resources Management Projects in many countries; and UNDP in Senegal. Integrated plant nutrition systems, integrated pest management and agroforestry are providing new packages for land rehabilitation and productivity increase. The Organization of African Unity (OAU) programme on the use of local minerals and organic resources as low-cost fertilizers and soil ameliorants is opening up new solutions to the problems of soil fertility depletion (UNEP, 1996). With these developments, hopes for advancements in sustainable development are more assured.

One important reason for the continued land-related environmental problems is that there are limited alternative industrial activities to reduce pressure on land. Furthermore, the declining terms of trade on agricultural commodities add pressure on land and contribute to continuing poverty. Governments have tried to expand and diversify the production structure throughout the industry sector. Generally, these efforts have focused on policies for developing institutional infrastructures that enable change. Additionally, there are also problems in reaching agreements among various stakeholders (government, the local community, foreign investors, and international financing agencies) on investment activities. The means to appraise the degree of success of various actions and their accountability are urgently needed (UNEP, 1996).

Desertification and drought. In Africa, desertification and drought are closely related to poverty, food security, and land degradation. The United Nations Convention to Combat Desertification has stimulated an early national response, especially the preparation of action plans. Solid information, particularly on trends, is generally lacking, and there is evidence of concrete results in only a few countries. Certainly, from the evidence of the country profiles, no country with serious land degradation has yet managed to control it.[2] Lack of trained staff (especially at the field level), and inadequate information, monitoring networks, and funding represent major constraints. In many countries, desertification has been exacerbated by fuel-wood collection, overgrazing, and poor land-use practices. In the field of drought monitoring and early warning, as well as of climate in general, regional initiatives include the establishment of a Climatology Network under AMCEN to provide a framework for action on climate-related issues. In light of the climate-related disasters experienced in the African region, it has become important, especially for countries affected by drought, to adopt policies and programmes to minimize the impacts of these disasters.[3]

[2] Regional co-operation in the field of land degradation has also been strengthened either directly through subregional institutions such as IGAD, SADC, and CILSS, and the African Development Bank (ADB), or indirectly through the institutes for applied research with the Consultative Group on International Agricultural Research (CGIAR).

[3] As part of the Climatology Network and under the World

Deforestation. Successful measures to prevent deforestation and to meet the need for fuelwood and other woodland products have been adopted through large-scale planting managed by Governments or companies for commercial timber production. For example, in Swaziland, one village that was given a plantation by the Government sold the timber with considerable returns (SARDC, 1994). Tanzania has built on traditional views regarding tree rights to install legal instruments to protect tree ownership. On the strength of this law, virtually every smallholder in the village planted trees along field boundaries, tempering escalating local conflicts over land access (SARDC, 1994). Attempts to reduce deforestation problems with fuel-saving stoves have, in general, not been successful in the Sub-Saharan region. This is primarily because fuelwood use is not the major cause of deforestation and also because the stoves were not appropriately designed or promoted. In rural settings, the actual consumption of fuelwood was not significantly reduced because the stoves could not be used for other purposes, such as heating and lighting.

The region has several innovative wildlife management strategies, such as game ranching and community-based management schemes, offering promising and practical alternatives to the standard approaches to wildlife conservation. Many of these are pioneered in southern Africa, such as the Communal Areas Management Programme For Indigenous Resources (CAMPFIRE) in Zimbabwe, launched in 1987; the Administrative Management Design for Game Management Areas (ADMADE) in Zambia; and the Selous Conservation Programme in Tanzania. The establishment of natural history museums and botanical gardens is also significant in conserving and documenting biodiversity.

Water-related issues. Countries are aware of the key role that is played by freshwater resources for future economic and social development. There is considerable activity to develop national freshwater strategies, basin plans, and demand studies. In Africa, policy-setting focuses on water assessment, integrated watershed management and development, water supply and sanitation, recently established transboundary water commissions, and economic instruments are being used to encourage conservation in some countries (SARDC, 1994, 11). Solving water-related issues is an important priority and includes providing sustained water and sanitation services to all people. Some examples of successful rural water supply and sanitation projects are found in Burkina Faso, Mali and Togo, featuring drilled wells with hand-pumps. Two examples of the most successful rural sanitation programmes in the region can be found in Lesotho and Zimbabwe (Ohlson, 1995). But future development of water-related issues would hinge on availability of appropriate technology, facilities, and management to harness available water. Water issues could be problematic because of the uneven distribution of freshwater resources and increasing demand for water for various activities such as agriculture, fisheries, mining, industry, and tourism.

Actions are also being taken at the sub-regional levels in the management and use of international waters and their basins. Only a few international river basins have been managed effectively through cooperation among riparian countries. One example of an important initiative is the Nile Basin Action Plan.[4] Many countries have developed their own energy policies. But at the regional level, cooperation in the energy sector is being forged in the framework of the African Energy Commission, a Ministerial Commission. This Commission is supported by the African Development Bank (ADB), ECA, and OAU with a goal to harmonies and coordinate the developments of the energy sector in Africa. There are also ongoing activities to develop hydroelectric power for common river basins through regional cooperation. Examples are the Gambia, Mano, Niger, Nile, Senegal, and Zambezi rivers. But the policy direction of Africa is to promote environmentally sound energy systems by ensuring that policies and policy instruments support and stimulate effective actions. These include developing and strengthening regional, sub-regional, and national legislative instruments on energy within the context of national environmental conservation programmes.[5]

Coastal and Marine Areas. With regard to coastal and marine areas, countries have various regulations

Climate Impacts and Response Strategies Programme (WCIRP), UNEP established a Climate Impacts and Response Strategy Network for Africa (CIRSNet/Africa) to share information and experiences to facilitate the development and implementation of climate-related activities, particularly climate change-related activities in the region.

[4] This has five main components (integrated water resources planning and management; capacity building; training and assessment; regional co-operation, including harmonisation of legislation and joint projects; and environmental protection and enhancement) and promotes a comprehensive and co-operative framework for the basin. Another is the SADC Protocol on Shared Watercourses Systems negotiated by 11 of the 12 members of SADC and signed so far by nine countries.

[5] Some of the most important issues to be addressed through regional policies and co-operation include reducing

in place to control activities in the areas of investment, fishing practices, oil spills, and withdrawal of coastal ground water. Environment Impact Assessments (EIAs) are mandatory for development projects in coastal zones. Some examples of regional initiatives on coastal and marine areas include the Regional Seas Programmes, such as for the West and Central African (WACAF) region and for the Eastern African (EAF) region. Also, there are agreements for management of coastal resources, such as the Eastern African Convention on the Protection of Coastal and Marine Environment. In general, the implementation of these regulatory measures has not been all that successful because of lack of coordination among various authorities; overlapping mandates of various institutions; and lack of resources, including skilled staff and financial and technical resources to enforce the laws. Existing local and national environmental policies are often compromised for the sake of short-term economic benefits, and the implementation of development projects often takes place without adequate environmental consideration (UNEP, 1996). As far as oceans, seas and coastal areas are concerned, there are efforts to prepare ocean or coastal management plans in Africa. However, at the same time, coastal erosion and pollution, urban development, and the lack of coordination are militating against progress.

Wastes and hazardous matters

This is an area where progress has been significant in many countries world-wide. Overall, the technical capacity to manage waste in African countries is low, but there is indication of an effort to control the use of agricultural chemicals and develop information systems for hazardous waste in some countries. In addition, in a few countries individual municipalities have conducted solid waste and sewage treatment pilot projects and are encouraging recycling. Constraints are generally related to issues of urban and integrated land planning and costs. In the case of hazardous wastes, progress has been undermined partly because appropriate technologies for storage are not available. An important regional agreement that deals with hazardous waste problems in Africa is the 1991 Bamako Convention on the Banning of Trans-boundary Movement of Toxic Waste. Importation of any hazardous wastes into Africa is outlawed under the Convention. Twenty-two countries are signatories and at least 10 countries are Parties to the Convention. But it is important to underscore that pollution from transportation remains a major problem in most urban areas. Carbon monoxide emissions, which continue to increase, are relevant for all countries. Less action has been taken in this area in Africa. But efforts are being made to develop strategies for the protection of the atmosphere and to conduct studies on energy substitution, air pollution, and the impact of climate change and adaptation to it. The most common concerns were related to pollution from transportation and the terrestrial and marine impacts of climate change.

Population, human settlement and health

In the area of demographics, it is clear that the 1994 United Nations Conference on Population and Development has had a positive influence on policies and planning in almost all countries. The common activities in this area include family planning, the active involvement of women in decision-making and regional settlement. Nonetheless, countries are generally not completely satisfied with the results on population issues. For many African countries, progress in these areas would depend on institutional development, research and information dissemination.

All countries have undergone urbanization, and the 1996 United Nations Habitat II Conference in Istanbul helped define issues and crystallize action in the area of human settlements in all regions. African countries are, however, at the early stage of urbanization, with relatively low urban proportions but high rates of urban population growth, leading to severe strains on urban areas and resulting in environmental degradation and urban sprawl. Priority is being given to the provision of housing, infrastructure, particularly improved sanitation, and the protection of open spaces.

In the area of health, some countries in Africa have experienced some improvements in the areas of life expectancy and infant mortality. There appears to be a movement towards integrated health policies, that is, health policies in combination with policies on poverty, education, human settlement, freshwater and waste disposal. But the least developed countries are struggling to have tangible results. On the whole, there appears to be a need for multi-agency strategy development, integrated programmes, and partnerships with major groups, including women, non-governmental organizations and the private sector (UNEP, 1996, 5). But as far as consumption patterns are concerned, efforts of African countries are largely to meet basic needs, but outside this, steps are being taken in individual countries to promote reduced energy consumption, improve nutrition, and rationalize resource use.

the pressure on natural vegetation cover through the development and use of alternative sources of energy and developing the energy potential of common river basins through systematic co-operation between riparian states to speed up sustainable development and economic integration.

United Nations organizations and international cooperation

The response of the United Nations system and the international community to sustainable development efforts in Africa has been one generally characterized by handicap. After Rio, there has been rapid growth in requests from developing countries and countries in transition for financial and technical support of initiatives related to implementing the objectives of Agenda 21. This created pressure for activities and projects leading to some results. Among other things, there has been increased support for model projects that help test and refine best practices.[6] The United Nations system, through the Inter-Agency Committee on Sustainable Development (IACSD) and UNDP, has therefore sought to promote an integrated approach to national strategies for sustainable development as a vehicle, inter alia, for relating capacity-building needs in different disciplines and sectors. UNDP's Capacity 21 Programme is intended to promote capacity building in relation to developing and implementing national strategies. Attempts were made to relate these to other exercises, such as that of the Country Strategy Notes or that of the World Bank-IMF Country Policy Frameworks, to ensure that a single framework is used for all country level activities.

Ironically, the period after UNCED has been characterized by stagnation in growth, if not reductions, in the regular budgets of most UN system organizations. This trend has not matched the increased demand and expectations in the implementation of sustainable development. New demands stemming from UNCED cannot be fully accommodated within existing resources. For most organizations, the level of extra-budgetary funds for Agenda 21 related activities have not increased. Therefore, agencies have been hard pressed to carry out both their mandated responsibilities and new responsibilities under UNCED. Even then, it has been further noted that where there has been some growth in extra-budgetary resources for sustainable development initiatives, such resources were, in most cases, earmarked for programmes of interest to donors. In effect there has often been disproportionate funding for certain countries and regions, for certain substantive areas, and in relation to particular functional activities.

Cooperation between UN organizations and the World Bank has grown substantially, for example in such areas as health, freshwater and food security. The Global Environmental Facility (GEF) is another example of improving cooperation between UN agencies and the World Bank for the purpose of providing financing to achieve the global environmental benefits in the areas of biodiversity, climate change, international waters and ozone layer depletion. The GEF was restructured by Participating States in 1994, with $2 billion pledged to its Trust Fund. It operates on the basis of collaboration and partnership among its Implementing Agencies, (UNDP, UNEP and the World Bank), as a mechanism for international cooperation for the purpose of providing new and additional grants and concessional funding to meet agreed incremental costs of measures to achieve global environmental benefits in the areas of biodiversity, climate change, international waters, ozone layer depletion, and possibly land degradation as it relates to the other four areas. As far as international cooperation and trade is concerned, there is general support for further liberalization and expansion of world trade and the establishment of a common institutional framework under the World Trade Organization. In Africa, there is commitment to the restructuring of the economy to encourage trade, fiscal reform, and a stronger private sector. International cooperation has allowed these policies to be implemented, but countries are still confronted with debt problems and difficult external trading conditions. Also, a number of countries are benefiting in regional economic integration arrangements in the context of trade expansion.

In conclusion, it is clear that progress in the implementation of Agenda 21 is "not much to write home about". Some spirited efforts have been made to set the process in motion. Activities have been prominent and alive at all levels — national, regional and international. But the results of actions could only be described as unpretentious in all areas because of various hindrances. The forces emanating from the weak socio-economic structures of African countries and the international environment have acted as powerful friction in the wheels of progress. At the national level progress in sustainable development is hindered by the shortage of skilled staff, paucity of training facilities, lack of integration and cooperation among institutions, inadequate information and incomplete integration of all stakeholders into sustainable development programmes. Also, sustainable development has been eroded as a result of some unintended counter-productive government policies. At the regional level, progress in sustainable development has been retarded as a result of weak coordination. There is undue duplication of effort and waste of scarce resources. Also, lack of commitments of countries to full participation in regional initiatives or programmes have not eased the process of sustainable development. In addition, the lack of financial

[6] The criteria for the selection of projects include (a) response to a real need in the country; (b) demonstration of significant economic, social or environmental benefits for the end-user; and (c) demonstration of governmental commitment and the infrastructure necessary for the project to have enduring results.

resources to support programmes poses enormous difficulties. At the international level, the major difficulty arises from inadequate and unpredictable funding of programmes in African countries. At the same time, the special interest of donor countries in some countries and sustainable development programmes has not made the judicious allocation of funds for sustainable development in Africa easy for multilateral organizations. All these problems would need to be more closely examined and appropriate solutions found in order to take sustainable development forward in Africa.

ODA FLOWS TO AFRICA

For the purposes of this paper, ODA is defined as the flows to developing countries by official agencies, including state and local governments, or by their executive agencies. The main objective of these flows is to promote economic development and alleviate poverty in developing countries. ODA is assumed to be concessional in character and contains a grant element of at least 25 per cent (based on a standard 10 per cent discount rate).[7] ODA includes both grants (inflows of unrequited transfers from official sources) for current and capital expenditures and disbursements of concessional loans.[8]

In the context of this definition, ODA flows to Africa have declined precipitously over the last two decades. This has taken place while internal developments in many African countries seem to have argued for steady increases. For many African countries, there has been an increasing need for foreign aid to assist in the development of social and economic infrastructures as they implement structural adjustment programmes and at the same time endeavour to meet their obligations in the promotion of sustainable development. The international community has also recognized the need to assist developing countries to overcome the limitations to development and their fulfilment of international development obligations. This was, for example, first illustrated in the ODA target of 0.7 per cent of GNP as recommended by the Pearson Commission in 1969. This was adopted by a resolution of the General Assembly in 1970. Annex table 1 illustrates the pattern of bilateral flows to African countries.

It is clear from the table that there has been a serious decline in bilateral ODA from DAC countries during this decade. Total bilateral disbursements to African countries were $16.7 billion in 1991. This fell to $13.6 billion in 1993, but rose to $14.5 billion in 1994. Thereafter, there has been a steep decline, falling to an all time low of $11.4 billion in 1997. The major recipients include Egypt, Mozambique, Tanzania, Morocco, Kenya, Ethiopia, Zambia, Ghana, Côte d'Ivoire, Senegal and Cameroon. Indeed, the trend in decline is also manifested when disbursements from other bilateral donors (Annex, table 2) are included, from $25.2 billion in 1991 to $21.5 billion in 1993, rising to $23.5 billion in 1994, but thereafter steeply declining to $18.7 billion in 1997. It will be observed that the flows to the America region during this period experienced some improvements. Total flows to the region in 1991 were about $6 billion. This fell to $5.6 billion in 1993, but steadily increased to $8.1 billion in 1996 and fell to $6.3 billion in 1997. During this period, it could also be observed that the flows to East and Central European countries did not experience significant decline. The average annual flow was $6.4 billion. There was a remarkable rise to $8.4 billion in 1995. However, Africa's share of total disbursements during this period did not experience major decline. The average annual share was 27.7 per cent. A high share of 29 per cent will be noted for 1992. This fell to 27.5 per cent in 1993, but rose to 29.3 per cent in 1994 but declined thereafter.

Thus, it could be observed that, contrary to expectations, bilateral flows to African countries have declined in the years after Rio. This has been a trend that has raised serious questions about the commitment of the developed countries to assist developing countries in the fulfilment of their obligations of Agenda 21.

The declining trend in ODA can, however, be understood in the context of the changing political and economic situations in Africa and world-wide that have significantly impinged on the donors' decision-making process for foreign aid disbursements to Africa. Beginning from the early 1980s, donors began to emphasize the need for African countries to implement structural adjustment programmes as a condition for the disbursement of aid. It was argued that the full engagement of African countries in a market economy would facilitate the absorption and effective utilization of foreign aid. In response, over 37 African countries implemented structural adjustment programmes, essentially propounded by the World Bank and International Monetary Fund (IMF). These countries were themselves convinced that adjustment programmes were needed to halt economic recession and to promote economic growth. By the mid-1980s many African countries had added the dimension of sound democracy, which they perceive as essential for sustainable economic growth. But the subsequent unfortunate events in a few African countries apparently changed the perception of the donors. The wars in the Horn of Africa embroiling Somalia, Ethiopia and Eritrea resulted in considerable human tragedy. Also,

[7] UNDP/The World Bank (1992, 307).

[8] Given the varying sources and definitions of data, the ODA flows in this section will not equal those that could be calculated by adding net disbursements of official concessional long-term loans and net official transfers.

the wars in Rwanda, Burundi Congo, Liberia and Sierra Leone caused enormous human and material losses in these countries. These wars shifted the attention of donors to emergency relief efforts in the countries concerned and in the neighbouring countries hosting refugees and displaced persons. At the same time, the feeling that the crises of these countries could have demonstration effects in other African countries did not encourage the flow of traditional ODA to them. In other words, the absence of wars could have aided the flow of ODA to Africa while most countries were committed to the implementation of structural adjustment programmes.

Furthermore, by 1990, the whole world witnessed an unexpected collapse of the former Soviet Union and consequently a reduction of East-West tensions. Prior to this, in 1989, the Berlin wall collapsed and brought about the unification of Germany. Although this development brought about a reduction in military expenditures by the developed countries, this has not translated into increases in the flow of resources to needy developing countries. This was the case because the collapse of the Soviet Union was accompanied by the severe erosion or demise of socialism in most developing countries. At the same time, the geographic strategic importance of many developing countries became less significant. This, in effect, reduced foreign aid to many developing countries, including those in Africa.

One important related development, with significant influence on the flow of aid to Africa, has been the effect of the emerging states in Central and Eastern Europe. The West could not look the other way but gave necessary support to the fragile market economies and democracies of these new states. Thus, the support of the developed countries to the economies in transition amounted to an erosion of the flow of aid to African countries. At the same time, the transition economies, most of which had hitherto been members of the Council for Mutual Economic Assistance (COMECON) and had in the past provided financial aid to African countries, reduced their flows to Africa to apparently negligible sums while they were confronted with major internal development needs. Generally, these states emerged into a market economy system severely handicapped, as they needed to consolidate macroeconomic policies, strengthen their infrastructure and rejuvenate their industrial sectors.

Another important factor accounting for the fall in bilateral aid to Africa has been the increased stringency among donor governments to reduce budgetary deficits at home. More stringent budgetary discipline has been motivated by the accumulation of debt from large deficits during the 1980s, concerns over the impact of high levels of expenditure and taxes on economic activity, and agreement to reduce fiscal deficits as a condition for attainment of monetary integration in the European Union (World Bank, 1999, 71).

Yet another important factor that seems to have undermined bilateral aid in the 1990s has been "aid fatigue" in the developed countries. As from the early 1990s, many developed countries began to show concern about the results of several decades of aid flows to African countries. The poor results from aid in the past were deemed to have occurred as a result of the inadequacies of the aid environment in African countries: weak economies as a result of weak economic policies, mismanagement, corruption and poor coordination of aid etc. While this view was held in many countries, foreign aid to Africa declined. Most developed countries hold the view that these problems should be addressed adequately by African countries if more aid is to flow into the continent. With the absence of African pressure groups within the developed countries, this view has not been seriously challenged.

Multilateral Flows

Annex table 3 presents the pattern of multilateral flows to African countries from 1991 to 1997. It is also obvious that there has basically been a declining trend. Total multilateral flows amounted to $8.8 billion in 1991. This rose to $9.7 billion in 1992 but thereafter declined from $9.1 billion in 1994 to a low of $6.8 billion in 1997. This is in sharp contrast to the trend in the Eastern and Central European region or the economies in transition. In 1991, multilateral flows to the region were $2.5 billion. This rose to $3.5 billion in 1993, $4.1 billion in 1995 and a record level of $6.5 billion in 1997, or a three-fold increase during the 1991-1997 period. A similar increase is also manifested in the America region, from $2.9 billion in 1991 to $5.6 billion in 1997, with a low of $1.3 billion only in 1992. The Asia region maintained the biggest amount in total flows, experiencing a big leap to $14.3 billion in 1997 from $9.1 billion in 1996. The share of Africa of total multilateral flows diminished substantially over this period, from 35 and 40.1 per cent in 1991 and 1992 respectively, but thereafter declining to 31.1 per cent in 1993. It rose to 33.5 per cent the following year, but declined to 30.7, 25.4 and 19.5 per cent in 1995, 1996 and 1997, respectively.

The trend in the flow of ODA from multilateral institutions has been largely dictated by the policies of these institutions and contributions received from donors. By the late 1980s environmental impacts carried considerable weight in the programmes and projects of bilateral donors. This development was accorded greater impetus by UNCED and the plan of action laid out in Agenda 21. Thus, the 1990s witnessed a new dynamism in bilateral agencies with respect to support for environmental sustainable development goals. This has been characterized by increased efforts among bilateral donors to work together towards coherent approaches to contribute to environmental sustainability through aid policies and programmes and increased attention to integrating environmental concerns at the institutional, policy and programme levels (United Nations, 1996, 37).

It will be noted that beginning with the early 1990s, OECD countries' foreign aid policies towards developing countries have been designed to promote sustainable and broad-based economic growth. The emphasis is on the stimulation of productive energies through investment in people and on participatory development. Foreign aid was directed to environmentally sound and sustainable development and the reduction of population growth. However, by the mid-1990s, in view of the changed situation in Africa, special emphasis was attached to averting conflict (OECD, 1994, 108-109). In addition, developing countries were expected to have implemented economic policies, including structural adjustment and good governance through the promotion of democracy. These policies are complementary to the promotion of sustainable development. They should be useful to the extent that they are harmonized with the policies designed for the promotion of sustainable development in African countries. Also, the flow of aid to African countries through multilateral institutions would depend, among other things, on convergence of the objectives and strategies of multilateral institutions with those of African countries for the promotion of sustainable development in African countries.

The issues of policies and programmes have been approached from both a cross-sectoral and global point of view. The review and evaluation of emerging trends and assessments of their effectiveness is another feature of the commitment among bilateral donors to the pursuit of environmental and sustainable development goals. As far as many bilateral agencies are concerned, the concept of sustainable development now serves as the guiding principle of development cooperation at the policy, programme and project levels. The ramifications of global environmental issues for development processes have received increased attention and are increasingly taken into account in the design, monitoring and evaluation of projects. In the follow-up to UNCED there has been increased coordination of efforts among aid agencies and other departments of ministries concerned (United Nations, 1996, 37).

Clearly, multilateral institutions have advantages for better foreign aid deliveries in African countries, through better coordination, freedom from aid tying and diverse technical support, to mention a few. The 1990s have shown an even sharper decrease in the channelling of aid through the multilateral institutions. Some of the reasons that appear to explain this are to be found in the reservations by the developed countries about the nature and style of operations of most of the important multilateral institutions. Many are considered too large and because of this it has been argued that the greater part of the resources received by them are consumed by the bureaucratic process rather than by programme implementation. The United Nations and most of its agencies, including UNDP, UNEP, etc., that are responsible for the implementation of sustainable development have been affected by this development. There is demand for restructuring and the streamlining of these bodies; effectively downsizing to save costs. The process of restructuring has begun, but contributions to these bodies have yet to increase to enable them to carry out their international obligations of facilitating the implementation of Agenda 21 in developing countries, particularly those in Africa.

CRITICAL ISSUES IN ODA AND SUSTAINABLE DEVELOPMENT

African countries have individually and collectively made some progress in the implementation of Agenda 21. The international community has, at the same time, provided some support in this direction to complement the efforts at the national, sub-regional and regional levels in Africa. However, it is clear from the overview of the performance of the continent that the road ahead towards the attainment of sustainable development is still fraught with difficulties. The weak economic position of many countries and the limitations which they continue to encounter in a rapidly globalizing world economy suggest that appropriate action should be taken at all levels to consolidate the gains made and accelerate the movement towards sustainable development. The dynamics of sustainable development should be carefully identified and consolidated, especially in the area of resources.

Halting and Reversing Declining ODA

In the context of the present state of sustainable development in Africa there is an urgent need to halt and reverse the present declining trend in ODA flows. This has clearly emerged as one of the major problems confronting policy-makers and administrators in African countries as they attempt to implement the programmes of Agenda 21. The decline in ODA should be arrested in order to give a new life to the process of sustainable development. But this exercise can only be done by coming to full grip with the fundamental problems posed by Africa's aid management, the transformations in the world economy and the responses from the international community.

Aid management and ODA

One factor that donors seem to utilize to explain the reduction in the flow of aid to African countries has been the internal situation in African countries. The internal environment appears to some to be not right to justify increases in the disbursements of more aid to African countries. Among other things, the weak economic performance of many countries has been cited as a discouragement for the inflow of aid. Poor aid coordination and management have been limiting factors. Also, corruption, as has often been stressed, has a negative impact on the allocation of aid to African countries. All these put together have culminated in what has been described as “aid fatigue” for Africa. The case for better aid coordination and management in recipient African countries cannot be over emphasized. This has been noted in several studies on aid to developing countries.

Poor aid management is linked to both institutional and personnel limitations. At the personnel level, there is a need for better commitment to aid projects. At the institutional level, relevant aid implementing institutions need to be free from political interference in order to function more effectively (Cassen, 1994, 117). A number of African countries have acknowledged the need for improvement in both areas. They have evolved policies to address corruption and mismanagement. They are developing better foreign aid institutions with relevant capacity and autonomy to ensure continuity in aid implementation and sound delivery of aid projects. The positive impact of foreign aid is likely to be more significant with better aid coordination and management. African countries therefore need to continue to strengthen their efforts to improve the environment for foreign aid in order to enhance its effectiveness for sustainable development. The efforts of African countries need to be complemented with support from donor countries since this development could, in the near future, assist in the termination of the need for additional aid. This apart, the more important cause of the decline in ODA flow to African countries emanated from the changing economic situation of donor countries.

Donor economies and ODA

At the external level, the decline in the flow of aid is to be found in the economic situation of donor countries, the financial limitations of the multilateral institutions and the changing circumstances in international relations. It was observed that increasing scarcity of fiscal resources was a major reason for the decline in ODA in the 1990s. Thus, most of the G-7 countries moved toward more restrained fiscal policies around 1993. Between 1993 and 1997, greater budgetary discipline was motivated by the accumulation of debt during the 1980s, concerns over the impact of high levels of expenditure and taxes on economic activity, and the agreement to reduce deficits as a condition of the European Monetary Union (EMU) (World Bank, 1999, 71). Also, donor countries generally take actions to ensure positive effects of ODA on their own economies, tying aid to purchases within donor countries or reducing aid expenditures outright when there is a need to ensure a balance in the balance-of-payments accounts. Aid tying, as has been noted in various studies, has reduced the volume and value of aid to developing countries. The basis has been challenged and the call made continuously for donor countries to make a distinction between aid and trade. The ability of recipient African countries to utilize aid for purchases at the cheapest source would enhance the value of aid. Outside this, the decision of the donors to disburse ODA during the 1990s has also been greatly influenced by some surprising developments.

International developments and ODA

Events in the international economy are in most cases beyond the control of individual countries. The implications of a positive or an adverse development can be far reaching for ODA flows out of any economy depending on its strength and extent of integration into the world economy. The recent developments in international relations have redefined the interests of developed countries away from African countries. Contrary to expectations, the collapse of the Soviet Union in the early 1990s did not yield a “peace dividend”, that is, it did not lead to a reduction in the arms race and a corresponding increase in the flow of aid to developing countries. The collapse resulted in the loss of strategic and political importance of many countries in Africa to the developed countries, both of which had been reasons for aid. The emergence of new and weak democracies in Eastern and Central Europe drew the attention of the developed countries to their development needs. These new democracies and their embryonic market economies needed to be supported in order to be consolidated and integrated into the world economy. African countries also lost aid from most of the Eastern and Central European countries as their resources were concentrated on national economic growth and development. In addition, wars in some regions of the world, such as in Europe, the Middle East and Africa, and natural disasters led to a reduction in development aid during the decade. For example, the share of ODA for emergency assistance required for natural disasters and recovery from civil war increased from about 5 per cent in 1990 to 9 per cent in 1994 (World Bank, 1999, 72).

In other words, new developments in international relations, especially those involving human tragedies, have acquired more importance than the global commitment to partnership for development, including those of sustainable development. Conflicts are inherent in human nature and are part of the characteristics of human society. The necessity for containment and resolution does not elicit any debate when the loss of human lives is involved. But the question is whether this should be at the considerable expense of the promotion of sustainable development. Sustainable development by itself represents an important ingredient towards peace and security in the long run. The international community may therefore need to address emergency global crises without unduly compromising the financial support for sustainable development.

The decline in ODA has been the single-most major blow to the serious advancement of sustainable development in Africa. The financial demands of Agenda 21 are huge. The implementation process began during the first half of the 1990s at a time when most countries in the continent started to recover from the long economic recession of the 1980s. The structural adjustment programmes implemented by African countries to this end also strengthened the need for increases in the inflow of financial resources. While these countries were confronted with the obligation to consolidate the gains in structural adjustment, they were at the same time handicapped by the paucity of autonomous internal financing, declining external trade as a result of the decline in the price and demand for major commodity exports, as well as adverse weather conditions. Also, those countries emerging into industrial production are confronted with the problems of access to the markets of the developed countries. Given these developments and requirements of African countries, the decline in ODA that occurred during this decade cannot be sufficiently justified. Again, some of the reasons for the reduction in disbursement of aid by the donor countries to African countries to adequately meet sustainable development needs are not highly convincing. The political and socio-economic situations in many African countries have improved substantially over the years to encourage increases in ODA. The case for increases in ODA flows to Africa cannot be stronger given the development partners' various pronouncements and commitments to international development and assistance to developing countries, especially those in Africa. African countries require significant increases in ODA in the short-run to establish the structure for the promotion of an enduring sustainable development.

Support for the Development Process

The promotion of sustainable development is intricately linked to overall development in Africa. A stable political environment and steady economic growth will facilitate the implementation of measures under Agenda 21. In this connection, concerns are in the areas of consolidation of democratic processes and the cessation of hostilities in the countries experiencing conflicts. At the economic level the issues concern keeping on track sound macro-economic policies and consolidating the gains of structural adjustment.

Political stability

At the political level, it has been observed that many African countries have in the last two decades engaged in meaningful programmes to establish democracy. In the past five years, thirty countries have put in place multi-party structures, conducted elections and established governments on the basis of popular participation. South Africa has abolished apartheid. Decentralization and community participation, stimulated by more open communication and free press, are on the increase in many countries. Governments in African countries are taking action to tackle endemic and systemic political problems such as corruption, mismanagement, denial of human rights, and lack of accountability in order to promote good governance. But all these require huge sums of money to address the legal and institutional arrangements to support these efforts. The financial resources of many countries to adequately address these issues are limited. There are constraints emerging from poor internal revenue arrangements as well as those imposed by the international economic environment. There currently exist a number of programmes, both bilateral and multilateral, to support the democratic process in African countries. For example, there is the UNDP Programme for the promotion of good governance in Africa. Additional financial and technical support is required by these countries to enable them to nurture and consolidate the incipient democratic process. Democracy could falter and spill-around, with all gains made thus far lost, if additional and adequate financial and technical support is not given to these countries. Conversely, the transition to a more open society, through the empowerment of the people at local and national levels, will facilitate environmental management.

The case of those countries that are in conflict or just emerging from conflict presents more difficulties. The difficulties are in the areas of refugees and internally displaced persons. In addition, these countries are confronted with infrastructure problems of large proportions. The international community has in the past responded to the problems of these countries at both bilateral and multilateral levels. However, it is clear that there is still a gap between the needs of these countries and the support received from all sources from the international community. The countries in crisis, or just emerging from crisis, are generally in a unique position to effectively address these issues and at the same time confront the promotion of sustainable development.

The international community has encouraged and supported the democratic process in Africa in the past. The donors and UN agencies such as UNDP have provided technical support to many countries in the region. However, while this has been very useful, it has generally been deficient and unpredictable. In effect, most democracies on the continent remain highly vulnerable. Sustainable development is incompatible with political instability. The social, environmental, and economic impacts of political instability are immense, as illustrated by the tragic events in Liberia and Rwanda. The political atmosphere must be supportive of environmental measures in order to promote sustainable development. The measures of sustainable development can be effectively implemented only through stable political institutions that provide the legal and institutional frameworks. There is a need for significant increased support for this group of countries. Political breakdown and civil strife could make sound environmental husbandry virtually unattainable.

Economic growth

At the economic level, the overall economic growth of African countries still remains very modest even though a turn around has been made in the recession that dogged growth and development. The implementation of structural adjustment programmes by many countries has assisted in the arrest of recession and facilitated the creation of a framework for further growth and development. The international community that has been instrumental to this process has provided support over the years. But it has been clear that the support has generally been inadequate and as a result there are possibilities that the growth process could stagnate and poverty could be accentuated. Nevertheless, it is abundantly clear that further economic growth and the promotion of sustainable development in these countries could be seriously undermined unless immediate action is taken to consolidate the achievements made so far and redress the critical impediments to economic growth. In the first place, continuous support is needed from the international community to African countries in their efforts to implement macroeconomic policies for durable economic growth and to integrate Agenda 21's environmental measures into national economic policies. This is undoubtedly a precondition for the implementation of environmental measures in African countries. Among other things, there should be strong support for measures designed to mobilize internal resources, for example, through reforming taxation systems, to support economic growth. The prospect of strengthening economic growth in Africa presents a promise of greater resources for the management of the environment.

The trends in external trade of African countries pose considerable difficulties for the promotion of sustainable development. The declining share of African countries in world trade was due, among other things, to a lack of access for the products of African countries into the markets of the developed countries. There is an urgent need for the developed countries to remove all impediments, administrative or quota, which hinder the exports of African countries. At the same time, there is a need for the diversification of exports of African countries to expand their export base and enhance export exchange earnings. The increase in foreign exchange earnings of African countries constitutes the most important factor for the independent promotion of sustainable development. The international community should assist the expansion of external trade of African countries in order to build an autonomous base for sustainable development and reduce dependence on ODA.

It is also clear that growth and the promotion of sustainable development in many African countries has significantly been undermined by the burden of external debt. External debt servicing for many countries has reached disturbing levels. As of 1996, the debt service-export ratio (ex-post) for the continent was 17 per cent. But for some countries such as Burundi and Somalia, it was over 50 per cent whereas for a few countries, such as Comoros and Congo Democratic Republic, it was about 3 per cent (World Bank, 1998, 180). There is an urgent need to address this problem in the context of the importance of sustainable development. The existing external debt strategies including, in particular, the Heavily Indebted Poor Countries Initiative (HIPC), are still inadequate for providing quick relief which most of these countries need for increases in resources to tackle effectively the measures on environment and development. The international community should therefore, as a matter of urgency, consider the possibilities of the cancellation of the external debt of the least developed countries as an option to enhance the capacity of these countries to meet their obligations of Agenda 21.

Diminishing ODA implies a covert denial of support for the development initiatives, both political and economic, in African countries. Democracy and market economy processes are in the formative stages in most African countries, excluding those experiencing conflict. These processes, which are mutually complementary, are weak and vulnerable. They will need to be well nurtured and strengthened to prevent their reversal so that they can effectively contribute to the process of sustainable development. Thus, the development process in African countries could be weakened and the promotion of sustainable development compromised if sufficient support is not forthcoming from the international community. The structures of democracy and economy must be sound to give support to sustainable development. But then the more problematic issues are in the extent of the contribution of ODA to basic areas, such as capacity building, for putting in motion the process of sustainable development.

Capacity Building

The failure to develop adequate manpower in African countries has made capacity building a major objective. Skilled manpower is lacking in many highly technical areas of development in this era of advanced technology and innovative approaches to development. African countries have, since the attainment of independence, been engaged in the improvement of this sector. It will be recalled that at independence most countries inherited very little skilled manpower. Governments of African countries have developed educational policies and programmes to address this problem. But sufficient progress is yet to be made in many countries for reasons of lack of financial resources to meet the requirements. It was noted that the implementation of Agenda 21 requires a full complement of skilled manpower at various levels and capacities. This has been well recognized in Agenda 21, especially as far as the developing countries are concerned. It was for this reason that many developed countries and multilateral institutions have provided support. Some countries have, through special programmes with African countries, sporadically assisted in the training of Africans. For example, UNDP under "Capacity 21" has made significant efforts in this connection. Also, other UN agencies and organs, including UNESCO and ECA, are involved in capacity building in Africa. But the efforts of these organizations to effectively assist African countries seem to have been weakened by reduced funding from donors.

Thus, as it is today, achievements in this area are still far from satisfactory for many countries in terms of the enormous and diverse technical issues associated with all aspects of Agenda 21. The process of building a robust base of skilled manpower for the implementation of Agenda 21 is still constrained, among other things, by inadequate funding. For the promotion of sustainable development on a long-term basis, the educational structure, including the education curriculum, needs to be strengthened. Educational institutions need to improve qualitatively. Additionally, more technical institutions need to be established in African countries to train Africans. The process towards sustainable development in Africa could be severely retarded unless sufficient ODA is received by African countries to complement internal efforts at capacity building.

Institutions

Traditionally, the process of development in African countries has entailed the establishment of development institutions for policy implementation. The adoption of Agenda 21 imposed obligations on all countries to have in place the relevant institutions to translate environmental measures into reality. This calls for the strengthening or creation of environmental institutions. It also calls for cooperation and harmonization of objectives and strategies among these institutions. Many African countries have made spirited efforts in this area since the adoption of Agenda 21. However, as it stands today, the progress made in this area varies from one country to another in the continent depending on the level of development. Some have made remarkable progress while others may be said to be at low levels on this issue. Generally, however, there still exists a gap between sustainable development requirements and available institutions. The consolidation or creation of environmental institutions, among other things, has suffered from the lack of resources. There have been constraints in the efforts by African countries to adequately and autonomously finance these institutions. The decline in foreign exchange earnings and poor internal revenue collection has constituted significant impediments in this connection. At the same time, efforts in this direction could not be pursued, particularly with the decline and unpredictable receipt of ODA.

Thus, given the current difficulties of many African countries to finance the relevant environmental institutions, there is a need for increased support from the international community. African countries should, from the outset, be sufficiently assisted in the creation of appropriate institutions to implement Agenda 21. Without adequate and strong institutions, Africa's attempt to complement global sustainable development could be seriously compromised. The international community should therefore increase technical and financial support to African countries to facilitate rapid development of environmental institutions.

Technology

Technology represents a vital factor in the process of development. For many countries in Africa, it is the critical missing link in development efforts. Thus, African countries have, in this domain, engaged in the formulation of appropriate policies for the development of technology. The development of indigenous technology and the encouragement of technology transfer have been considered most practical for rapid development. But these, among other things, entailed information and finance which have been scarce for most countries. The importation costs of technology have, in many cases, been out of reach for many developing African countries. The implementation of many aspects of Agenda 21 requires application of appropriate and some new forms of technology. It is clear from the efforts made so far in the implementation of Agenda 21 that the paucity of appropriate technology has posed some difficulties. This could reach monumental proportions by the time more incursions are made into the complex areas of Agenda 21. The problems associated with appropriate and new technology in Africa are many. These range from the deficiencies in domestic policies to the paucity of funds.

Thus, the limited progress in sustainable development could be interpreted in the context of these overwhelming factors, namely, the precipitous decline in ODA and the weak internal economic situation, making it difficult to mobilize resources for rapid implementation of the programmes of Agenda 21. The decline in ODA derives from several negative influences that emanate both from donor and recipient countries. The decline in ODA has, on the whole, weakened the efforts made by African countries, both individually and collectively, to promote sustainable development and raised serious questions about its future. The present weak economic conditions in many countries also derive from a weak domestic economic policy base and deleterious international economic influences. But it is clear that the process of sustainable development in Africa is now at a critical phase. The process runs the risk of coming to a standstill if business is carried out as usual. There is a need for more imaginative approaches. The decline in ODA should be halted and reversed and a new impetus provided to the process of sustainable development in Africa.

TOWARDS PROGRESS IN ODA AND SUSTAINABLE DEVELOPMENT

International cooperation for sustainable development in Africa cannot be business as usual in the new millennium if the objectives of Agenda 21 are to be attained. The challenges of sustainable development in developing countries, especially those in Africa, are still enormous in view of the over 100 programmes that are to be implemented under Agenda 21. At the same time, the programmes being implemented so far are few compared with the progress made in other regions, such as Asia, Europe and Latin America. There is a need for Africa to have tangible results by Rio + 10 in the year 2002. But this could only materialize if new and more sublime methods are found to existing problems and new action plans laid out to address in a more integrated manner the diverse problems of ODA and sustainable development. The dynamics of ODA must be effectively harnessed to ensure that Africa will be fully part of the global sustainable development process.

National Level

If the flow of ODA is to significantly increase to meet the enormous demands of sustainable development in African countries, these countries themselves must continue to take all necessary internal measures to enhance its inflow. The commitment to the creation of the right environment would enhance the inflow of ODA. Among other things, better and innovative ways of harmonizing and coordinating policies would be a significant improvement.

Policy: Improvements in coordination

There is a need for progress and new methods in policy coordination in order to ensure a greater positive impact of ODA on sustainable development. African governments must intensify the integration of environment policies into national development policies. Efforts should be made to ensure effective harmonization of the interests of both bilateral and multilateral donors into national environment policies. There should be adequate coordination of policies among environmental institutions. The governments of African countries need, at the same time, to avoid the adoption of other national policies that may be counter-productive to environment policies. The effective coordination of policies is a precondition for sustainable development on the continent. The process of sustainable development could be severely constrained in the frame of non-complementary policies.

Institutions

The institutions on environment provide the structure for the long-term implementation of Agenda 21. One obvious observation from this study is that many African countries have not gone far enough in the establishment of appropriate institutions. There is a need for a renewed approach to tackle this issue. African governments should explore new autarkic ways of funding the consolidation or establishment of these institutions and make them functional. This could be done through new forms of taxation on environmental issues and support of the private sector. The support of the community must also be sought. Both bilateral and multilateral donors should be encouraged to provide sufficient technical and financial support for effective operation of environment institutions. One particular area of need of these institutions is in the training of a good complement of staff for their effective operation. The United Nations agencies, including UNDP, could assist in this area. This is the time to have the right institutions in place for sustainable development in African countries. The process of sustainable development could be unduly handicapped unless African countries and the international community take prompt actions.

Aid: Increasing effectiveness

In many parts of Sub-Saharan Africa, much has been done over the last decade and a half to liberalize prices, foreign trade, and the exchange system under structural adjustment programmes. Obviously, this has not been a small achievement not only in terms of the sacrifices, such as the social and political costs, made but also in the visible pickup of economic growth. New and innovative approaches must be devised to tackle, on a permanent basis, the problems of corruption and mismanagement that are primary sources of concern to many bilateral donors. There is a need for more transparency in the utility of commodity grants and concessional loans to public enterprises. Corruption and mismanagement have in many cases combined to lead to the unsatisfactory completion of aid projects. Many African countries have already acknowledged the need for correcting these social ills. But the observation is that they are still a long way away from a satisfactory situation in these matters. There is therefore the need for more stringent laws and regulations to deter corruption and mismanagement. There is a need to develop a culture of a corruption-free society. The principle of accountability should be more unequivocally held as a high priority in the hierarchy of administration in African countries. The more sound the administrative process, which will also lead to better aid results, the more likely there will also be increases in ODA flows.

The effectiveness of foreign aid in the sustainable development process in Africa will also hinge on the judicious selection of projects for financing. Several measures have been proposed for implementation under Agenda 21 towards sustainable development. As it is, many African countries have commenced work in some key areas such as the creation of an appropriate legal framework, appropriate institutions and capacity building. In all of these areas, the desired satisfactory levels have yet to be attained to build the basis for sound sustainable development. It is necessary that African countries and donor countries work more closely to identify the critical levers in these areas that would ensure rapid positive demonstration effects in other areas of Agenda 21.

Full utilization of allocated ODA

Even though there has been a decline in ODA over the years, it has at the same time been observed that large amounts of allocated funds by OECD countries are not disbursed. The undisbursed proportion of allocated ODA should be more closely examined, as this represents a significant amount in total allocation each year and a loss to the promotion of sustainable development. The administrative, political and economic bottlenecks to full disbursement should be identified and appropriate solutions found. It is not uncommon that available grants or technical assistance have not been effectively utilized because of insufficient information. Doing this would lead to additional resource flows for sustainable development.

Regional Level

Regional institutions are important to the implementation of Agenda 21 and the attainment of sustainable development in Africa. Many environmental issues are transnational in nature and could best be solved collectively at sub-regional and regional levels. The regional development banks, intergovernmental organizations, and non-governmental organizations need to intensify their commitments to sustainable development in Africa. They should assist in the generation of additional ODA to African countries, while acting within their respective mandates. As it is today, the resource flows from regional and sub-regional development banks in Africa constitute a minute proportion of the overall ODA flows to Africa. This, to some extent, will be accounted for by the limitations imposed by the charter and defined objectives of the banks. In institutions where this is a major problem, efforts should be made for adjustments to accommodate sustainable development. Sustainable development issues should be more integrated into the development assistance policies to African countries. Broadening the base of ODA will enhance the possibility for steady increases in inflows and assure predictability in the implementation of the measures and programmes on sustainable development.

International Level

If African countries are to meaningfully carry out their obligations under Agenda 21, it is imperative that the international community, at both bilateral and multilateral levels, should effectively honour their commitments to provide additional resources on a timely basis.

Political will: the need for consolidation. The basic question in the flow of ODA to African countries is political will to support the development process. This has to be strong over time in order to ensure increases in inflows. Political will is generally related to expected results, either in terms of benefits to the donors or positive outcomes in the recipient countries. The decade of the 1990s has witnessed the waning of political will with some countries disillusioned about the impact of foreign aid in the development process in Africa. This tendency and view may not be sufficiently justified in the context of the various internal and external overwhelming negative factors that have frustrated the development process in African countries in recent years. However, in view of the spurt of economic growth in most countries in the last seven years, there is a cause for the emergence of stronger political will to support the development process in African countries. Sufficient ODA should be disbursed to African countries to enable the building of momentum for the take-off of sustainable development.

Aid constituency. The allocation of scarce resources to increasing competing demands in the developed countries entails both economic and political considerations. Actions taken by lawmakers on the allocation and disbursement of ODA in the developed countries could be influenced by the inputs of pressure groups. Negative pressure from the local constituency of lawmakers has generally had the result of limiting the flow of ODA. As it is presently, African countries lack the constituency to advocate for continuous and sufficient flow of ODA for sustainable development. Aid constituency is necessary to clearly articulate the importance of sufficient ODA flows in the process of development in African countries. Aid constituency should be created to inform the public and the lawmakers in the developed countries of the positive impact of ODA and why it is only an exercise for the short-run which aims for the creation of the structure for durable development. The NGOs and multilateral institutions cannot do this alone for Africa. African countries should assist and get involved in the creation and operation of aid constituencies in the developed countries. Lawmakers need to be more effectively lobbied to arrest the decline in ODA.

Disbursements: adequate and timely. One of the original concepts of ODA to developing countries in the early 1950s sees it as filling a savings investment gap. In this context, it was envisaged that a sufficient inflow of foreign financial assistance, over a period of time, was what was needed to raise production and income to a level that will lead to adequate domestic savings being made for investment. Today the same is still true of many African countries where the level of savings is very low and grossly inadequate for the desired level of investments. The investment situation appears much larger when the dimensions of sustainable development are added. As already noted, the decline in aid and its unpredictability has indirectly made the need for huge inflow inevitable. The present conditions call for adequate ODA flows to African countries over a number of years sufficient to assist in the building of the necessary momentum for the right level of investment and the take-off of sustainable development. This strategy is practicable as African countries become more efficient in the management and utility of ODA. The model will, in the long run, be cost-effective for the donor countries since after the given period at which ODA has provided the right level of investment, additional ODA will no longer be required.

Aid tying reduction. Aid tying was one of the characteristics of ODA in the 1960s but continues to undermine the flow of ODA and its effect on sustainable development in the 1990s. The time has come for donor countries to effectively separate aid from trade. In the present global economic dispensation, it is superfluous to continue to view aid as a means for promoting trade and the stimulation of growth. The multilateralism of the World Trade Organization (WTO) has offered more robust channels for the expansion of trade of member countries. It is most imperative for donors to take appropriate action to substantially reduce or eliminate aid tying to make ODA more meaningful to recipient African countries. The future of sustainable development would be better in Africa if more aid funds are utilized for the purchase of capital goods from the cheapest sources in the world market.

Policy performance: support for specific needs. The late 1980s and early 1990s witnessed a strong emphasis of the donor countries on policy implementation by developing countries, including those in Africa, as the yardstick for aid disbursements. Prior to this period most African countries were in deep economic recession. But they have all fully acknowledged, since the mid-1980s, that a sound democratic process and structural adjustment programmes are mutually reinforcing strategies for the implementation of Agenda 21. African governments, both individually and collectively, have made strong pronouncements on these in their development plans and joint declarations and resolutions at the Summits of the Heads of State and Government of the OAU (See for example, OAU, 1995). Today, these are processes well entrenched and irreversible in many countries. While this is the pattern of development in many countries, the yardstick of implementation of political and economic policies becomes superfluous. In the current economic dispensation in African countries, the yardstick should be the specific needs of African countries, particularly the need of African countries to meet sustainable development challenges as integrated into their development plans.

Enhancement of autonomous financing. It must be recognized that ODA alone cannot and should not be conceived as the primary source for sustainable development in Africa. Sustainable development will be attained when ODA is available to effectively complement robust domestic resources. In this connection, there is an urgent need to remove impediments to the external trade of African countries. As a first step, the international community should, as a matter of urgency, address the question of market access of African countries to the markets of the developed countries. The Ministerial Meeting of the World Trade Organization, scheduled for November/December 1999 in Seattle, USA offers a vital forum to find more realistic practical solutions. Market access for the industrial products of African countries in the markets of developed countries together with improvements in the prices of commodity exports would create a more sound resource base for African countries to tackle the implementation of Agenda 21. In the same vein, the international community should more seriously consider the limitation to autonomous resources placed by the burden of external debt of African countries. Debt cancellation should be considered an important option along with the HIPC strategy, especially for the least developed countries. The resources released from debt should effectively be diverted to the implementation of the projects and programmes of Agenda 21.

Indigenous technology. The lack of technology represents the weakest link in the process of development in African countries. This has much to do with a weak educational base and lack of resources for its development. The lack of information and of resources have also been reasons for their inability to import technology for development. It has also been noted that the institutional support for the development of technology is feeble in most countries. Agenda 21 encourages the transfer of appropriate technology from developed to developing countries to facilitate sustainable development. This has not been without problems, as the transfer is largely associated with the information and cooperation of multinational corporations. However, it is obvious that in the long term the future of sustainable development in Africa may well hinge on the development of indigenous technology. An increase in ODA to this sector would therefore be most highly desirable to address the issue of policy, information gathering and sharing, the coordination of research results within and between African countries, and for the establishment of research institutions in the region.

Enhancing the capacity of multilateral agencies. Multilateral agencies, especially those of the United Nations, have no funds of their own but depend on the contributions from donors in order to support the sustainable development process in developing countries. These agencies have in recent years witnessed a dramatic reduction in contributions from the donor countries largely for reasons related to performance. It has been argued that the UN and its agencies are too large and some times too old-fashioned to effectively address the current global development issues. Hence, the call for the restructuring and streamlining of its agencies. Over the past two years, the UN Secretary General has embarked on a restructuring process. Agencies, including UNDP, have been streamlined. But this has apparently not produced the desired effects from the donors. Contributions to UNDP have tended to dry up as it was being streamlined. Contributions to non-core resources in which donors have control over the way donations are expended have increased at the expense of core resources controlled by the agency and in which Africa has the largest take home portion. This development suggests the fears and interests of donors are elsewhere, and that they are presumably in dissatisfaction with the emerging structure of the agency.

However, sustainable development is not likely to be effectively promoted with a continuous weakening of the agency while it is starved for funds to meet its programmes on sustainable development, especially of Capacity 21. There is an urgent need to reverse the declining contributions to UNDP. The agency may not at all times be able to fully respond to the special interests of one or some few countries given the unique circumstances of the changes being carried out and of its operation. This should be weighed more against the unique advantages of the agency for facilitating sustainable development, particularly the coordination of aid and channelling to priority sustainable development programmes on the ground in African countries. Additionally, the technical resources available to African countries from UNDP is larger than that of any individual country acting alone collaborating with African countries in the promotion of sustainable development. Thus, donors should increase resource flows to multilateral agencies to enhance their capacity to perform. Sustainable development in Africa runs the risk of serious erosion if the decline in donations from donor countries persists.

Thus, in order to take sustainable development forward in Africa at the turn of the century it is important that sufficient attention should be accorded to the dynamics of ODA in a changing environment. The attitude towards aid by both the donor and the recipient will need to change to ensure increases in the flow of ODA. Some old obstacles to ODA will need to be perceived through a different prism to acknowledge the need for additional ODA flows. Also, taking sustainable development forward will require the tapping of the complementary forces of domestic resources and ODA.

CONCLUSIONS

The promotion of sustainable development in Africa since Rio could at best be described as reasonable when compared with the performance of other regions and given the enthusiasm that heralded the negotiation and adoption of the programme in 1992. Although the level of implementation varies from one country to another and from one sub-region to the other, nevertheless the broad areas of activities for all countries have been those primary areas that are fundamental to long-term sustainable development. The critical areas of focus at national, regional and international levels to which all efforts have converged include the integration of Agenda 21 measures into national economic policies, strengthening environmental laws and creating them where they do not exist. There have been actions in the consolidation of environmental institutions and the creation of new ones where they do not exist. Other actions relate to environmental impact assessments and capacity building. But major actions here remain incomplete and unsatisfactory for most countries for lack of funds and skilled manpower. Regional actions have been very encouraging with intergovernmental organizations taking the leading role in the articulation of the path which African countries should individually and collectively take in the all-important programme that is vital to the future of mankind.

On the substantive issues of Agenda 21, incursions have been made into natural resource management covering land and water-related issues, agriculture and rural development, deforestation and coastal and marine areas, poverty, population, human settlements and health, and waste and hazardous materials. Again, progress on these issues in each country or sub-region remains largely intangible for reasons of paucity of funds and skilled manpower. The weak economic positions of many African countries have been a major limitation to their attempts to make advancements in the implementation of the programme. But the more serious disappointment came from the decline in ODA. The precipitous decline in ODA almost immediately after Rio took the wind out of the sail of all initiatives both at national and sub-regional levels and, in effect, left major environmental programmes to spill around, thanks to the disillusionment with the role of ODA in the development process in African countries.

But the important question here is whether the international community could abandon expressed commitments to increase flows of ODA to African countries for the implementation of Agenda 21. Logically the answer should be no. The gains made so far could evaporate into thin air if not consolidated with sufficient increases in ODA. The promotion of global sustainable development for mankind would suffer if Africa lags behind. Environmental degradation knows no national boundary. The implications of continued environmental degradation in Africa would have ramifications for other regions and prove devastating to current efforts at poverty eradication. It is therefore imperative that the international community increase its political will in the commitment to an authentic international development underscored by the preservation of the environment. In the interim, the weak African countries should be sufficiently assisted financially and technically in order to be brought into the mainstream of global sustainable development.■

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ANNEX

Table 1. Net Disbursements of ODA by DAC Countries Combined to African Countries ($ million)

	1991	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*
South of Sahara							
Angola	158.9	194.0	151.4	224.0	241.7	294.4	227.0
Benin	160.0	171.2	147.7	142.0	177.4	164.9	148.0
Botswana	104.2	93.4	80.1	56.7	54.5	67.9	55.8
Burkina Faso	270.1	267.6	254.7	264.7	252.3	269.2	217.9
Burundi	122.9	148.8	125.75	108.5	108.4	67.8	38.2
Cameroon	377.1	579.0	528.0	397.0	345.5	279.6	330.2
Cape Verde	79.1	80.0	81.4	81.5	76.9	77.5	68.0
Central African Rep.	98.1	106.71	116.8	94.2	122.4	121.0	61.3
Chad	137.6	148.4	145.7	103.5	127.0	121.8	96.4
Comoros	30.5	23.1	28.8	17.8	21.7	22.0	15.3
Congo Dem. Rep.	342.71	162.7	99.1	97.3	117.7	106.3	104.5
Congo Rep.	117.7	101.7	116.3	252.9	105.0	394.6	260.0
Cote d'Ivoire	434.7	527.4	708.5	820.2	726.6	449.2	232.7
Djibouti	82.9	92.0	94.0	94.2	79.6	70.8	62.2
Equatorial Guinea	35.2	35.9	27.7	16.5	21.7	23.3	17.8
Eritrea	-	-	48.1	95.7	94.6	124.8	80.9
Ethiopia	464.4	457.0	417.1	566.9	525.5	445.4	372.5
Gabon	140.5	64.8	97.5	161.2	135.6	113.4	30.2
Gambia	55.0	50.4	49.9	38.2	25.1	17.2	17.4
Ghana	448.6	332.7	312.4	331.8	358.6	348.9	291.9
Guinea	173.3	233.5	184.6	186.3	220.4	134.7	125.5
Guinea-Bissau	62.3	56.8	56.5	123.5	76.9	124.8	58.5
Kenya	608.4	519.7	426.5	400.5	458.7	345.7	301.0
Lesotho	74.1	69.0	73.8	45.5	61.6	49.3	44.6
Liberia	56.7	26.1	24.6	35.5	31.1	112.4	31.0
Madagascar	274.2	215.5	227.8	189.9	194.9	229.8	549.0
Malawi	208.7	207.9	158.6	251.1	220.9	263.9	174.0
Mali	279.7	239.1	221.0	243.0	285.1	297.5	256.6
Mauritania	110.36	116.4	196.0	128.1	126.0	98.8	95.5
Mauritius	61.5	34.7	26.8	7.7	11.0	-1.1	2.7
Mayotte	71.4	73.2	82.1	96.4	106.2	123.9	102.3
Mozambique	769.3	1006.9	812.8	733.0	698.3	551.9	621.6
Namibia	95.1	97.9	122.8	112.5	147.7	136.4	122.9
Niger	264.4	262.0	254.0	261.5	193.9	163.2	181.2
Nigeria	171.62	137.7	71.0	47.3	72.6	47.3	52.2
Rwanda	232.9	187.5	201.4	487.4	339.2	252.0	178.7

Table 1. (continued)

	1991	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*
South of Sahara							
St. Helena	14.8	15.2	14.1	13.1	12.4	15.4	14.8
Sao Tome & Principe	24.1	26.1	28.3	26.4	61.5	28.9	21.2
Senegal	421.4	454.0	363.8	475.1	399.4	392.0	292.0
Seychelles	16.8	15.4	6.8	7.3	11.0	7.8	6.3
Sierra Leone	67.9	74.1	105.7	53.8	59.6	67.0	41.4
Somalia	116.0	497.3	687.9	437.6	119.2	39.6	46.0
South Africa	-	-	183.3	214.4	318.5	311.9	415.0
Sudan	368.8	187.5	164.1	174.5	130.6	118.1	85.7
Swaziland	31.1	26.7	33.4	27.5	37.7	20.6	16.3
Tanzania	763.8	816.2	650.1	570.3	586.7	605.4	569.1
Togo	124.5	134.9	77.2	63.5	117.8	97.2	75.7
Uganda	285.3	254.8	347.8	344.5	423.1	369.9	438.8
Zambia	582.8	699.0	510.6	434.0	439.5	354.1	367.0
Zimbabwe	359.2	535.8	310.1	280.3	347.7	280.8	222.5
South of Sahara (unallocated)	600.0	682.1	393.3	434.4	364.8	469.4	361.4
Total	10950.0	11539.8	10647.4	10870.3	10391.8	9688.5	8598.8
North of Sahara							
Algeria	306.9	375.5	265.1	373.5	289.8	263.0	192.5
Egypt	4157.0	2996.2	1823.8	2310.7	1689.5	1933.3	1496.3
Libya	3.0	1.5	2.0	1.8	3.2	2.1	1.8
Morocco	610.8	733.7	422.0	317.9	347.4	391.4	215.2
Tunisia	263.9	298.2	126.8	72.7	52.1	41.5	69.3
North of Sahara (unallocated)	5.7	5.5	3.5	7.8	23.8	12.2	12.9
Total	534.3	4410.5	2643.1	3084.3	2405.8	2643.3	1987.9
Africa Unspecified	389.2	385.5	266.4	578.6	433.9	496.3	791.4
Africa Total	16686.5	16335.8	13556.9	14533.2	13231.5	12828.1	11378.1
America	4856.7	4293.7	4263.8	4550.0	4798.7	5757.4	3920.9
Middle East	3783.4	2871.8	2086.8	3061.8	1715.3	3597.5	1355.3
Asia	13349.3	13602.8	12176.0	13910.3	12481.7	11975.1	8119.9
CEEC/INIS	4985.5	5203.5	5217.1	5549.5	7087.0	4036.8	4041.8

Source: OECD, Geographical Distribution of Financial Flows to Aid Recipients 1993-1997, p. 64.

Table 2. Net disbursements of ODA from all sources
Combined to regions ($ millions)

	1991	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*
South of Sahara	17690.0	19143.5	17330.0	18912.0	18488.7	16748.5	15065.5
North of Sahara	6986.3	5366.7	3737.3	3908.3	2981.1	3362.5	2881.3
Africa Total	25208.5	25029.8	21476.9	23531.4	22055.3	20680.6	18743.9
Europe	2241.0	2284.0	3411.5	2196.3	2284.6	2518.4	2002.7
America	5998.0	5587.8	5605.2	6150.1	6861.7	8185.1	6270.8
Middle East	5076.1	3738.8	3128.7	4392.9	2908.3	4870.3	2549.3
Asia	20272.4	19724.9	17611.3	21118.2	18767.6	18973.3	14545.1
CEEC/INIS	6574.2	6057.1	5952.6	6863.2	8420.0	5602.3	5634.2
Total	90046.5	86932.6	78253.5	87072.4	82767.3	80941.0	67692.8
Percentage Africa	28.0	29.0	27.5	29.3	26.7	25.6	27.7

Source: OECD, Geographical Distribution of Financial Flows to Aid Recipients 1993-1997, (OECD: Paris), p. 64.

Table 3. Net Disbursements from Multilateral Agencies
to African Countries ($millions)

	1991	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*
South of Sahara							
Angola	135.2	166.4	139.8	227.0	176.7	249.7	208.6
Benin	108.4	98.8	140.2	110.5	96.9	122.0	78.5
Botswana	42.9	35.5	35.3	-1.7	-1.9	-14.5	43.9
Burkina Faso	140.7	167.9	210.6	167.1	227.3	145.5	147.7
Burundi	134.8	161.6	92.2	203.4	181.4	133.2	77.7
Cameroon	250.9	229.2	-13.0	284.4	-9.1	68.7	80.5
Cape Verde	24.7	42.1	34.7	38.4	39.6	39.0	40.8
Central African Rep.	73.3	76.1	56.5	71.8	44.8	44.4	30.5
Chad	126.0	92.4	79.2	110.2	111.8	180.4	123.7
Comoros	29.0	24.5	21.2	22.2	21.8	18.0	12.8
Congo Dem. Rep.	212.8	97.4	77.7	146.7	76.8	57.4	54.9
Congo Rep.	13.5	11.7	4.2	147.8	2.4	52.7	-9.1
Cote d'Ivoire	382.4	311.2	-22.7	653.5	426.7	291.8	28.5
Djibouti	22.6	22.1	30.2	23.3	23.5	21.8	19.9
Equatorial Guinea	20.5	24.6	25.3	13.8	12.2	6.2	6.0
Eritrea	-	-	19.3	50.4	50.2	29.5	29.5
Ethiopia	642.6	737.0	684.0	511.3	379.4	440.1	300.5
Gabon	29.2	12.2	15.4	106.6	46.2	23.4	8.5
Gambia	45.9	64.4	37.0	33.4	22.2	21.7	24.0
Ghana	451.0	301.5	390.3	203.1	124.7	280.8	168.7
Guinea	197.1	233.7	259.8	205.1	209.3	157.9	226.2
Guinea-Bissau	51.3	45.2	38.0	51.6	36.3	53.1	66.3
Kenya	214.4	300.3	376.1	175.6	185.9	171.8	75.5
Lesotho	49.3	75.4	90.8	87.9	62.3	59.2	45.2
Liberia	100.3	93.3	97.5	27.7	91.7	94.0	64.4
Madagascar	178.2	139.3	132.3	92.4	103.8	128.9	263.5
Malawi	308.8	351.2	325.0	207.9	196.5	224.2	168.4
Mali	172.5	192.0	165.0	212.8	314.4	235.0	201.8
Mauritania	99.7	114.8	132.7	138.9	118.5	179.8	156.9
Mauritius	3.0	-4.7	-12.4	-9.3	-4.1	11.7	21.6
Mayotte	0.8	1.5	1.2	8.3	1.5	5.8	1.9
Mozambique	303.3	458.3	369.0	487.7	397.5	371.1	336.9
Namibia	89.1	45.5	31.9	31.9	45.0	54.3	42.8
Niger	107.0	108.0	77.6	108.0	79.0	94.3	148.2

Table 3. (continued)

	1991	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*
South of Sahara							
Nigeria	291.9	400.3	407.9	232.7	-31.9	-139.7	-111.0
Rwanda	127.3	165.8	154.5	226.4	373.4	421.5	412.3
St. Helena	0.5	0.6	0.6	1.0	0.2	0.5	0.3
Sao Tome & Principe	27.2	30.8	18.6	23.3	22.8	18.1	12.3
Senegal	178.2	254.3	182.0	177.8	233.4	160.5	106.3
Seychelles	4.2	8.0	16.0	10.1	6.2	11.5	7.7
Sierra Leone	35.6	63.2	105.5	222.3	143.1	124.3	87.5
Somalia	70.2	146.1	193.2	99.9	72.1	51.4	56.9
South Africa	-	-	92.0	80.2	67.5	90.9	159.4
Sudan	490.0	350.4	293.0	240.3	123.2	126.9	102.7
Swaziland	19.7	21.8	17.8	18.6	17.4	23.2	21.3
Tanzania	277.8	496.6	266.0	355.7	268.1	270.3	373.4
Togo	73.4	89.6	18.9	59.9	74.2	68.4	49.0
Uganda	311.3	447.0	243.3	383.8	390.5	308.0	398.0
Zambia	116.6	312.0	303.3	210.4	1524.7	205.2	201.5
Zimbabwe	139.5	425.1	351.3	235.3	94.9	78.5	104.9
South of Sahara Unallocated	11.1	102.8	20.5	203.8	55.0	427.1	383.9
Total	6935.4	8144.6	6826.2	7731.1	7325.7	6299.3	5661.8
North of Sahara							
Algeria	400.7	242.8	205.5	215.9	401.9	307.5	484.6
Egypt	285.7	332.3	346.0	335.2	78.2	140.3	450.7
Libya	23.4	4.9	4.0	5.1	5.2	7.9	7.3
Morocco	521.4	586.0	505.8	387.4	216.7	398.1	43.6
Tunisia	480.1	244.2	425.6	222.0	120.9	234.0	164.1
North of Sahara Unallocated	0.0	7.6	38.2	41.4	46.8	42.2	8.2
Total	1711.4	1418.0	1525.1	1207.0	869.8	1129.9	1158.5
Africa Unspecified	150.8	145.7	145.3	137.5	155.1	72.8	6.5
Africa Total	8797.5	9708.2	8496.6	9075.6	8350.6	7501.9	6826.8
Europe	158.4	544.9	1186.0	130.5	196.8	1163.7	906.4
America	2948.4	1284.8	4195.6	3319.8	4059.3	5761.8	5584.5
Middle East	960.8	873.1	848.7	964.8	1195.2	1207.7	841.7
Asia	9789.1	8459.9	9082.7	9421.8	9364.0	9137.8	14344.2
CEEC/INIS	2448.9	3001.8	3468.6	4172.9	4074.2	4782.0	6453.8
Total all Regions	25103.1	23872.7	27278.2	27085.4	27240.1	29559.9	34957.4
Percentage Africa	35.0	40.7	31.1	33.5	30.7	25.4	19.5

Source: OECD, Geographical Distribution of Financial Flows to Aid Recipients 1973-1997 (OECD: Paris), p.72.

DEBT RELIEF AND SUSTAINABLE DEVELOPMENT IN SUB-SAHARA AFRICA

*Nguyuru H.I. Lipumba**

EXECUTIVE SUMMARY

For a large number of heavily indebted poor countries, the traditional debt rescheduling exercises have neither delivered debt sustainability nor promoted sustainable growth with debt reduction. The Heavily Indebted Poor Countries (HIPC) Initiative is an improvement over the previous rescheduling exercises. It is, however, a very slow process and its sustainability measures do not focus on the fiscal crisis of African governments. Debt sustainability should be determined by the ability of governments to raise revenues to pay the debt while providing necessary infrastructure and social services and without imposing an enormous tax burden on the private sector (which will discourage investment). The debt relief provided so far is not adequate to guarantee debt sustainability for countries exporting primary commodities that face volatile commodity prices. The enhanced HIPC initiative agreed after the 1999 G-8 Cologne Summit deepens debt relief and links it to attaining monitorable targets in poverty reduction and social development.

Broad-based economic growth and poverty eradication is a do-it-yourself process. International bureaucrats cannot drive it. Financial and technical assistance from outside can help an internally driven process. If assistance from outside dominates the policy-making process aimed at poverty eradicating growth, it is more likely to fail. Debt relief can help development efforts of a country by removing the debt overhang problem and allowing policy to focus on promoting broad-based growth. It is, however, doubtful that the provision of debt relief can be used by the international community to twist the hands of policy-makers to focus on poverty eradication. Linking debt relief to the implementing of IMF and World Bank conditionalities undermines policy ownership that is necessary for poverty-reducing growth. Donors can assist in promoting poverty-reducing growth by linking the provision of new aid resources to countries that have democratically elected governments pursuing appropriate policies. Across the board debt cancellation is the appropriate policy for removing the debt crisis of African countries that will allow serious governments to pursue poverty-reducing growth strategies. The moral hazard problem is exaggerated. Countries with bad policies are not servicing their debt in the first place. Governments that are serious about promoting broad-based development have to spend more time negotiating debt relief when they should be designing poverty-reducing policies.

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INTRODUCTION

SUSTAINABLE development entails three sets of interrelated objectives: economic development, social development and environmental protection. To attain sustainable growth, human and natural resources have to be used efficiently to promote growth of output and income. This growth should lead to the reduction of poverty while protecting the environment. Sustained reduction in poverty and improvement in the provision of social services, such as basic education, preventive and curative medicine, clean water and adequate shelter, requires broad-based growth of output. Although sustained long-term growth is usually dependent on technological progress, it is also associated with capital accumulation because technical progress is usually embodied in new capital goods. The necessary, but not sufficient, condition for sustained high growth of output is large levels of investment.

Poor countries such as those of Sub-Saharan Africa lack capital. In the framework of a debt-cycle hypothesis, countries that lack capital are expected to borrow and use foreign savings to increase domestic investment and growth. As income increases, domestic savings will increase and enable the borrowing country to pay the external debt. During the 1970s, Sub-Saharan Africa borrowed abroad but these loans did not promote sustainable growth of output and exports. The "Volcker" recession of the early 1980s and the collapse of Africa's terms of trade ignited the debt crisis. For over a decade Sub-Saharan African countries have faced a debt crisis that has retarded growth, undermined poverty reduction and degraded the environment.

This paper analyses the potential role of debt relief in supporting sustainable development. The paper first discusses the role of debt flows in promoting growth and sustainable development. It then analyses the so-called traditional mechanisms of external debt relief, discusses the impact of the HIPC Debt Initiative, discusses the Enhanced HIPC Debt Initiative, and, finally, discusses policies for promoting poverty-eradicating growth in Sub-Saharan Africa.

DEBT FLOWS AND ECONOMIC GROWTH

The central neoclassical view of international capital markets is that capital will be "reallocated from developed countries, where it is relatively abundant and its return is lower, to developing countries, where capital is more scarce and its return higher" (Cline, 1995, 141).

There are implicit requirements for the growth-through-debt model to work in practice. First, external loans should be used to increase investment rather than finance consumption or, worse, capital flight. Second, allocation and utilization of investment must be efficient. External loans should not be used to finance monuments such as new capital cities or highly protected, inefficient, import-substituting industries. Third, external loans must be used in projects that directly or indirectly produce tradable goods, so as to save or generate foreign exchange that is required to service the debt. Fourth, domestic savings should actually increase as the economy grows. Fifth, debt exporters should be willing to provide stable and predictable flows.

Surges of external loans to developing countries were not a logical workout of the debt-cycle hypothesis. Developing countries did not have access to international commercial bank loans before the 1973-74 oil price increase. The huge increase in revenues in oil-exporting countries, which were deposited in international banks operating in Europe, led to the rapid expansion of the petrodollar market. The oil price increase initiated a prolonged recession in industrialized countries and a decrease in the demand for loanable funds. International banks were increasingly eager to recycle the petrodollars, even to some countries in Africa. For most Sub-Saharan African countries, however, the predominant source of loans was official bilateral and multilateral creditors, although several countries were able to borrow commercially in the 1970s. Loans were available at low interest rates that were negative in real terms. The 'push' factors, such as the availability of loanable funds from bank deposits of oil-exporting countries and low demand for credit in industrialized countries experiencing recession and low interest rates— rather than the 'pull' factors of competitive, low-cost producers and high productivity in developing countries— initiated the surge of commercial bank lending to these countries.

The servicing of external loans appeared easy because of the commodity booms of the mid-1970s. Neither private nor official creditors were overly concerned about how their loans were used, nor bothered by the overall policy and institutional framework of borrowing countries. Most of the loans were to sovereign governments and international bankers tended to believe that countries never become insolvent and could always be squeezed and cajoled with the help of the International Monetary Fund to pay up their debts.

Several factors guaranteed debt-servicing problems when real interest rates turned highly positive and the terms of trade of traditional exports deteriorated: an institutional framework that promoted inefficient investment; overvalued exchange rates; highly protected, import-substituting industry that was biased against production of exportable goods; and the expectation that interest rates would remain low. Most countries did not have effective debt recording, monitoring and management systems. The debt crisis of the 1980s showed the risks of opening up to debt flows.

The extension of loans to African countries was largely influenced by cold war rivalry and less by rational economic calculations of the productivity of external borrowing in African economies. The growth of debt was too high compared to the growth of exports (Annex, table 1). Most countries did not maintain good records of their external obligation but continued to have access to official credit from Western governments and, to a lesser extent, socialist countries. African governments seem to have perceived most of the external loans as grants. During the "Cold War" period the supply of loans created its own demand, regardless of the loans' contribution to economic growth. In the 1970s, lending governments and international financial institutions generally ignored the moral hazard issue that had been used in the 1980s and 1990s to delay and deny debt relief to heavily indebted countries.

The beginning of the world debt crisis is reckoned to have started in 1982 after Mexico failed to service its debt. Some African countries entered the debt crisis earlier than Mexico. As early as 1977, Tanzania's debt arrears on principal and interest exceeded the value of exports. In 1980, at least six countries, including Central African Republic, Chad, Mali, Mauritania, Sudan and Tanzania, had arrears exceeding 20 percent of their exports (Annex, table 2). The aggregate size of African debt was small and owed to official creditors and therefore did not have any impact on the international banking system. International efforts to address the African debt crisis had to wait for the action of non-governmental organizations such as OXFAM and CAFORD.

In retrospect, external borrowing was not the best way of utilizing foreign savings, particularly for Sub-Saharan countries, which had limited efficient formal sector private enterprises and few medium-sized local entrepreneurs. For public guaranteed debt, the country commits itself to service the debt and pay the principal, regardless of the profitability of the activity financed by external loans. Sub-Saharan African countries are poor and have limited entrepreneurial and technological capability. Foreign direct investment offers a better alternative for capital inflow than external borrowing because the investor takes the responsibility for managing the investment and the risk of failure. Only if the investment is profitable can the investor repatriate profits. If the investment is successful, the profit rate is likely to be higher than the interest rate on external loans, and hence the amount that can be repatriated will be larger than in the case of servicing external loans. This is not a problem if foreign firms generate or save foreign exchange. Foreign investment can be immiserising if domestic distortions are large, and foreign firms are established to monopolize protected domestic markets and earn monopoly rents. Debt accumulation in African countries neither increased the effective capital stock nor promoted growth.

THE TRADITIONAL MECHANISM OF EXTERNAL DEBT RELIEF

At the outset, the debt crisis was largely considered a liquidity problem causing temporary balance of payments problems. Early strategies involved non-concessional rescheduling of payments falling due and new lending packages linked to IMF stabilization and structural adjustment programs. Twenty-seven countries that are now classified as HIPCs agreed to 81 non-concessional flow reschedulings under Paris Club arrangements between 1976 and 1988. In the second half of the mid-1980s, creditor nations reluctantly accepted that heavily indebted countries face not only a liquidity problem but also a solvency problem. Since the mid-1980s, bilateral creditors have used a wide range of instruments to address the debt burden of poor countries, most of which are in Sub-Saharan Africa. The traditional mechanism of addressing the debt burden of poor countries has focused on debtor countries implementing stabilization and structural adjustment programmes supported by the International Monetary Fund and the World Bank. This mechanism included flow rescheduling agreements with Paris Club creditors followed by stock of debt operations for countries with a three year good track record implementing IMF supported programmes. Debtor countries also have to agree to seek at least similar terms from non-Paris Club creditors (that is, use the most-favoured creditor principle), bilateral forgiveness of ODA debt, and new financing on concessional terms. For a large number of heavily indebted poor countries, the traditional debt rescheduling exercises have neither delivered debt sustainability nor promoted sustainable growth with debt reduction. The integrity of the Paris Club rescheduling exercises was undermined as countries continued to accumulate debt payment arrears after every rescheduling. Why has the debt crisis persisted despite the adoption of structural adjustment and debt rescheduling exercises?

Implementing IMF Stabilization Programmes

In the past decade most of the heavily indebted poor countries in Africa have implemented IMF supported stabilization programmes. Their foreign exchange regimes have been liberalized. They have accepted IMF Article VIII obligations not to impose payment restrictions on current account transactions. The dates of the most recent three IMF programmes are shown in Annex table 3. Nineteen HIPCs of Sub-Saharan Africa have continuously implemented IMF programmes for at least three years in the 1990s. Of these 19, eleven countries, including Benin, Burkina Faso, Ethiopia, Guinea, Malawi, Mali, Mauritania, Mozambique, Tanzania, Togo and Uganda, had at least six years of implementing IMF programmes in the 1990s. Inflation has been drastically reduced in many countries. These reforms, however, have yet to make a significant impact in terms of initiating and sustaining high growth of exports and output.

Paris Club Debt Rescheduling

The Paris Club rescheduling of the early 1980s was mainly non-concessional, with a grace period of only five years and maturity of ten years, and used market-based interest rates. Repeated rescheduling of these standard terms did not resolve the debt crisis of most countries, which continued to accumulate debt payment arrears. Indebted countries needed more than cash flow relief. The stock of debt was just too high to be effectively serviced. Although the inability of the poor countries to service their debt did not affect in any way the finances of creditor countries, the latter were slow to act on the predicament of the former. In 1988, creditor countries introduced concessional rescheduling on “Toronto terms”. The menu of options under the Toronto terms could provide debt and debt service reduction of up to a third of the net present value of the rescheduled debt. However, the Toronto terms did not solve the debt crisis of poor countries. In 1991, creditor nations improved the terms of concessional rescheduling, the so-called London terms, which were expected to provide debt relief of up to 50 per cent of the net present value of the eligible debt. However, the London terms did not do the trick, either, and in 1994 creditor nations introduced the Naples terms that replaced the Toronto and London terms. Under the Naples terms, countries could receive a reduction in eligible non-ODA debt of up to 67 per cent in terms of net present value. The Lyon terms increased debt relief of up to 80 per cent of net present value of eligible debt.

The Paris Club rescheduling excluded the debt of multilateral financial institutions that continued to have the status of preferred debt that had to be fully serviced before a country could even apply for Paris Club rescheduling.

Many heavily indebted African countries have gone through a number of debt rescheduling exercises. Between 1986 and 1997, Tanzania had five Paris Club debt reschedulings. After each one, debt payment arrears continued to accumulate. The Paris Club commitment of reducing debt of up to a third under the Toronto terms, a half under the London terms, two-thirds under the Naples terms and 80 per cent under the Lyon terms have not led to a large reduction in nominal debt stock. Multilateral debt, which accounted for 40 to 60 per cent of poor countries’ debt, was not included. Paris Club creditors did not offer the maximum reduction of eligible debt or cancel the ODA debt. The amount of debt cancelled during the 1985-97 period as a percentage of debt in 1985 and 1997 is shown in Annex table 4. Among countries that rescheduled their debts during the 1985-97 period, only Benin, Burkina Faso, Central African Republic and Senegal reduced their 1985 debt stock by at least 50 per cent. It appears that France was more generous in canceling the debt of her former colonies. Less than 20 per cent of the Sub-Saharan debt of 1985 was cancelled during this period.

A large share of resources from creditor nations has been provided as grants. Although ODA assistance has been decreasing since 1994, Sub-Saharan Africa has received the largest share of ODA. It should also be noted that despite the heavy debt burden most countries in Sub-Saharan Africa had overall positive net resource transfers (Annex, table 5). Even when we consider debt flows only, net resource transfers have been positive throughout the 1980s and 1990s. The only countries with large negative net gross resource transfers, relative to their GNP, are not HIPCs. They are the mineral rich countries of Botswana and Gabon, and, surprisingly, Swaziland. Nigeria has also recorded negative net resource transfers for a number of years.

If the net resource transfers have remained positive in HIPCs then why the fuss about the debt crisis strangling African economies? First, positive net resource transfers are partly the result of accumulating debt payment arrears. If these countries fully serviced their debt then their net resource transfers would be negative. Second, positive net resource flows are misleading with respect to the budget constraint problem facing governments. Most aid projects are not incorporated into the budget process. The funds are usually not available for budget allocation and are tied to projects selected by donors with cosmetic participation by debtor governments. The purchase of imports is usually tied to the country providing aid. Debt service has to be paid out of a country’s recurrent revenue.

Large future debt servicing obligations and debt payment arrears cause debt overhang problems that discourage investment in a debtor country. Future debt servicing will require increased taxes. Investing in a country with a large debt service obligation may imply high taxes and social instability in the future. Domestic and foreign investors may hesitate to commit themselves in such economies. Countries with large debt payment arrears will have problems accessing international capital markets, thereby reducing external capital inflow and encouraging capital flight. Private capital markets are highly sensitive of countries that routinely run debt payment arrears. As Martin (1997, 150) has noted “All creditworthiness and ratings analyses on which foreign investors rely include strong negative debt elements. Those running portfolio investment funds in Africa or attempting to promote investor interest in HIPC privatizations assess the existence of debt overhang as a key negative influence. Some incentives, such as export credit guarantees, are directly cut off as a consequence of a debt overhang". The debt overhang stifles investment and growth. Resolving the debt crisis is a prerequisite for building African creditworthiness in the medium and long terms.

The debt sustainability measures do not focus on the fiscal crisis of African governments. Debt sustainability should be determined by the ability of government to raise revenues to pay the debt while providing necessary infrastructure and social services and without imposing an enormous tax burden on the private sector (which will discourage investment). Sachs (1996) has suggested that African countries can start growing fast if they strengthen the rule of law, lower the highest marginal tax rates to 20-30 per cent, adopt uniform tariff rates of 10 per cent, and limit government expenditure to 20 per cent of GDP, to be roughly allocated as follows: education (5 per cent), health (3 per cent), public administration (2 per cent), army and police (3 per cent), and government investment (5 per cent), mainly in road infrastructure, particularly rural roads. This type of minimalist expenditure on essential areas does not leave any revenues for debt servicing. Many African countries, including the favoured reformers such as Ghana and Uganda, are unable to raise 18 per cent of their GDP in fiscal revenues.

Tax revenue, as a percentage of GDP, for selected Sub-Saharan African countries is shown in Annex table 6. Most countries are unable to collect 20 per cent or more of their GDP in taxes. The exceptions are some mineral exporting countries such as Botswana, Gabon, Namibia, South Africa, Zimbabwe and the small middle-income economies of Mauritius and Swaziland.

If governments are unable to service their external debt, they are also likely to be unable to service their domestic debt obligations. A government that routinely accumulates debt payment arrears will not have the fiscal discipline that is necessary for both maintaining macroeconomic stability and efficient utilization of public resources to promote sustainable growth and poverty alleviation. Effective public expenditure management cannot be attained if governments are required to set aside 20-40 per cent of their revenue to service external debt that was, in the first place, unproductively utilized and failed to promote growth. It is widely recognized that "improving government performance requires, among other things, sustained commitment of, and political support from, key governmental and societal players and a realistic time frame to carry out appropriately sequenced reforms" (World Bank, 1999b). Public expenditure management is critical for maintaining and sustaining fiscal discipline to promote macroeconomic stability. It is also important for the prioritization of expenditures to support sustainable and poverty-reducing growth. High debt service obligations will undermine political support of reformers who want to bring discipline and improve management of public finances.

THE IMPACT OF THE HEAVILY INDEBTED POOR COUNTRIES (HIPC) DEBT INITIATIVE

The failure of the traditional mechanism of debt reduction and the pressure of NGOs calling for debt cancellation of poor countries implementing policies that support human development led the IMF and World Bank to propose the Heavily Indebted Poor Countries (HIPC) Debt Initiative in 1996. This initiative was meant to deal, in a comprehensive manner, with the overall debt burden of poor countries. The HIPC Initiative is guided by six principles: (i) the provision of a durable exit strategy by targeting overall debt sustainability on a case by case basis; (ii) debtor countries should have a track record of their ability to put the expected debt relief to good use; (iii) new measures will build on the Paris Club mechanism; (iv) broad coordination of all creditors to provide debt relief on an equitable basis; (v) preservation of the preferred creditor status and financial integrity of the multilateral financial institutions, which are also expected to provide debt relief; (vi) new external financing on concessional terms.

Boote and Thugge (1997, 140) were confident that the HIPC Initiative could resolve the debt crisis of poor countries. They asserted that "the HIPC Debt Initiative completes the array of instruments available to the international community to reduce the debt burden of these countries to sustainable levels, and for the countries to exit from the debt rescheduling process, provided they are prepared to adopt and pursue strong programmes of adjustment and reform. Implementation of the initiative should eliminate debt as an impediment to economic development and growth, and enable HIPC governments to focus on the difficult policies and reforms required to remove the remaining impediments to achieving sustainable development."

The original HIPC Initiative required debtor nations to have a track record of at least three years implementing IMF stabilization programmes before reaching a decision point whereby creditors made a commitment to provide sufficient debt relief to reduce the debt burden of eligible countries to sustainable levels, provided a country completes another three years of implementing a stabilization programme supervised by the IMF.

The HIPC Initiative considers that external debt sustainability is attained when a country is able to meet its debt service obligations promptly without accumulating debt payment arrears, rescheduling of debts or requesting debt relief. The servicing of debt should not adversely affect growth. The indicators used to determine debt sustainability are the debt export and debt service ratios. When the HIPC Debt Initiative was introduced in 1996 the IMF and World Bank set debt sustainability targets of a net present value debt-to-export ratio of 200-250 per cent and debt service ratio of 20-25 per cent. Later, a fiscal indicator was introduced for very open economies. Countries with an export-to-GDP-ratio of 40 per cent and a revenue-to-GDP ratio of 30 per cent could qualify for HIPC debt relief if the net present value of debt to government revenue was 280 per cent or higher. Only poor countries that have these characteristics and can only borrow from the World Bank at International Development Association (IDA) terms are eligible. Nigeria, a member of the HIPC with an enormous debt overhang problem, does not qualify even when it implements IMF supported stabilization programs.

Among the 41 countries that were classified by the IMF and World Bank as HIPCs, 33 are in Sub-Saharan Africa. The implementation of the HIPC initiative has been slow, requiring a six year track record of implementing IMF and World Bank supported reforms before reaching completion point. Since the adoption of the HIPC initiative in 1996, out of 29 eligible countries, only Uganda, Guyana, Bolivia and Mozambique have received debt relief under this mechanism. Mozambique has received the most generous debt relief. The nominal debt has been reduced by $3.7 billion, equivalent to 63 per cent of the net present value of total debt. Uganda's debt has only been reduced by 20 per cent.

Côte d'Ivoire, Burkina Faso and Mali have reached a decision point and are in the pipeline to receive debt relief between the end of 1999 and 2001. Benin and Senegal reached a decision point and their debt was considered sustainable after receiving Paris Club rescheduling using the Naples terms.

The HIPC initiative is an improvement to the previous rescheduling exercises. It is, however, a very slow process. Only two African countries have received HIPC debt relief. Qualifying for an early completion point seems to be largely a public relations exercise from NGOs. Although Burkina Faso reached a decision point in September 1997, before Mozambique (April 1998), its debt relief is expected in the year 2000 while Mozambique reached its completion point in 1999. Burkina Faso has been as good a reformer as Mozambique. International NGOs and bilateral donors better championed the plight of Mozambique while Burkina Faso did not attract similar attention.

The debt relief provided is not adequate to guarantee debt sustainability for countries exporting primary commodities that face volatile commodity prices. Even after being the first country to receive debt relief under the HIPC initiative, the recent collapse of coffee prices makes Uganda's debt service unsustainable. The HIPC initiative reduced Uganda's overdue external debt by $650 million, or 20 per cent of the nominal value of the debt. The IMF concluded that Uganda's debt was sustainable after the 20 per cent debt reduction. It projected that the debt-servicing ratio of Uganda will decrease to an annual average of 14.5 per cent from 1998-99 to 2000-01, compared to an average of 22.2 per cent from 1995-96 to 1997-98. This reduction in debt service can be attained if the value of exports (in US dollars) grows at an annual average rate of 15.4 per cent over the period from 1998-99 to 2000-01, which is too optimistic, given the current weak commodity prices. The trend growth rate of Uganda's exports quantity index from 1986 to 1996 was only 0.4 per cent. The optimistic projections seem to be based on the unusual export performances of 1994 and 1995, which were associated with a coffee price boom and good weather conditions leading to a bumper coffee harvest. Ugandan tax collection is around 10-11 per cent of GDP. The export-to-GDP ratio is still low, around 12 per cent of GDP. A debt servicing ratio of 15 per cent implies using 1.5 per cent of GDP, or 15 per cent of tax revenue, to service debt. Can Uganda afford to service its debt and invest in poverty eradication? Without continued development assistance, Uganda will not be able to service its debt.

THE ENHANCED HIPC INITIATIVE

The international civil society has been critical of the too little, too late approach of implementing the HIPC Initiative. The G-7 Cologne Summit responded by proposing the Enhanced HIPC Initiative that should not only aim at sustainable debt levels but assist in promoting sustainable growth with debt reduction. The cash flow savings from debt relief should be used in the social sectors, particularly education and health. The IMF and the World Bank have been challenged to work with eligible countries to develop strategies of poverty reduction that should be integrated into the overall macroeconomic policy framework. The Enhanced HIPC Initiative aims at linking debt relief with the attainment of a number of internationally agreed targets for the year 2015 (relative to 1990). These include reducing the incidence of extreme poverty by half, reducing infant and child mortality by two-thirds, achieving universal enrolment in primary education, and eliminating gender disparity in education (by 2005).

In order to provide faster, deeper and broader debt relief, the benchmarks for debt sustainability have been reduced. The net present value debt-to-export benchmark has been lowered from its initial range of 200-250 per cent to 150 per cent. The benchmark for the debt service ratio is now 20 per cent rather than a range of 20-25 per cent. The fiscal benchmark, in the form of the net present value debt-to-fiscal ratio has been lowered from 280 to 250 per cent. The qualifying export to GDP ratio and revenue to GDP thresholds for the fiscal benchmark have been lowered from 40 to 30 per cent and from 20 to 15 per cent respectively. The bilateral donors are committed to forgiving 90 per cent of the ODA debt for countries qualifying under the Enhanced HIPC Initiative.

The track record of implementing reforms under World Bank and IMF supervision has been reduced to a minimum of three years rather than six years with the adoption of floating completion points, whereby countries can receive debt relief if they are considered to be strong reformers implementing poverty-reduction programs. The tying of the provision of debt relief to the implementation of poverty-reducing strategies, rather than simply adopting policies to maintain macroeconomic stability, has the potential of increasing the time required before a country can receive debt relief. Reducing poverty significantly takes time. Designing an institutional framework for a sustained improvement in both the quality and quantity of education and health services is a long-term process.

Designing and formulating appropriate policies to foster broad-based poverty-reducing growth and monitoring progress in attaining development goals requires the availability of accurate and timely statistics. Many HIPC countries do not have reliable social economic data. In Tanzania, for example, even national accounts are unreliable. The 1997 revised national accounts have increased GDP estimates of 1988 and 1992 by 263 and 68 per cent respectively. Government revenues as a percentage of GDP in 1992 decreased from 20 per cent to 12 per cent simply as a result of revising the national accounts. A tax effort that was considered reasonable before the revised accounts was apparently too low. The implication of earlier estimates of national accounts is that fiscal adjustment should focus more on reducing expenditure rather than raising taxes. The revised accounts suggest low tax effort and the need to increase tax collection through better tax administration. Many HIPCs do not have reliable social indicators such as net primary school enrollment rates, student-teacher ratios, and children malnutrition rates. Governments are not even aware of the correct number of their employees and soldiers. Can these governments prepare realistic poverty reduction strategy papers with monitorable social indicators before reaching a decision point in order to receive debt relief under the Enhanced HIPC?

The easily monitorable indicators such as budgetary allocation may not necessarily reflect sustainable improvements in social indicators. Crash programmes to increase primary school enrollments may be attained at the cost of drastically reducing the quality of education that may undermine increases in numeracy and literacy among the population.

The new benchmarks have increased the number of eligible countries from 29 to 33. It has also increased the amount of debt relief to be offered to HIPCs. Debt relief for poverty reduction continues to be tied to implementing IMF and World Bank programmes. The World Bank has proposed a comprehensive development framework (CDF) that goes beyond the "Washington Consensus" policies that was the basis of structural adjustment programs. The CDF goes beyond promoting growth, low inflation and balance of payments equilibrium and directly incorporates human development, particularly improvement in education, health and longevity of the whole population. According to Stiglitz and Wolfensohn (1999) "The World Bank's development objectives are focused on the achievement of democratic, equitable, and sustainable increases in living standards." Economic growth is seen as a necessary, but not sufficient, condition for sustained progress in other measures of well being, including education, health and nutrition. They argue that "to reduce misery and improve living standards, equity and sustainability must come to be viewed as essential complements to growth, not substitutes. Achieving rapid growth at the cost of relegating a significant portion of the population to poverty, or substantially degrading the environment — even if such trade-offs existed — would not represent sound policy. The old approach of an exclusive focus on growth as the elixir for all the world's problems is thus too circumscribed. Such a trickle-down approach ignores the substantial social gains from growth directed towards the poor. In other words, the quality of economic development — not just its existence — can be important."

The CDF framework has been criticized as too "fuzzy" and "using buzz-words of ageing hippies" and may undermine development by not focusing on growth. Development is a multifaceted process and involves building institutions that sustain the broad provision of education and basic health, promote participation in productive economic activities by establishing stable rules of the game such as widely accepted property rights, competition and the rule of law. There is no single factor that can guarantee poverty-reducing growth. The important question is can an international financial institution promote democratic and equitable development in poor countries?

The World Bank has not yet fully operationalized the CDF. The framework for poverty reduction is expected to have the following key elements: (i) poverty is multi-dimensional and is not limited to a lack of access to social services; (ii) high economic growth is a necessary condition for sustained poverty reduction; (iii) poverty reduction must have transparent poverty-related goals that can be monitored using proxy intermediate indicators; and (iv) sustained implementation of an anti-poverty strategy requires broad participation of civil society in both preparing and monitoring the programme.

The World Bank (1999a) has argued that "to design a consistent poverty framework, it is vital to have a good understanding of the determinants of poverty. Presentation of information on the levels and trends in poverty outcomes and intermediate indicators is necessary, but not sufficient, for developing an outcome-oriented strategy. The next step is to assemble and distill information on the causal processes underlying human development, poverty and inequality outcomes." This is a tall research agenda for ministries of finance and planning in poor African countries. If the enhanced HIPC debt relief is conditional on the preparation of detailed poverty reduction framework papers that are fully owned and can be implemented by African governments, few countries will qualify.

Broad-based economic growth and poverty eradication is a do-it-yourself process. International bureaucrats cannot drive it. Financial and technical assistance from outside can help an internally driven process. If assistance from outside dominates the policy-making process aimed at poverty-eradicating growth, it is more likely to fail. Debt relief can help the development efforts of a country by removing the debt overhang problem and allowing policy to focus on promoting broad-based growth. It is, however, doubtful that the provision of debt relief can be used by the international community to twist the hands of policy-makers to focus on poverty eradication. Linking debt relief to implementing IMF and World Bank conditionalities undermine policy ownership that is necessary for poverty-reducing growth. Donors can assist in promoting poverty-reducing growth by linking the provision of new aid resources to countries that have democratically elected governments pursuing appropriate policies. Across the board debt cancellation is the appropriate policy for removing the debt crisis of African countries that will allow serious governments to pursue poverty-reducing growth strategies. The moral hazard problem is exaggerated. Countries with bad policies are not servicing their debt in the first place. Governments that are serious about promoting broad-based development have to spend more time negotiating debt relief than designing poverty-reducing policies.

POLICIES FOR PROMOTING SUSTAINABLE POVERTY-REDUCING GROWTH

After fifty years of development experience, there are generally accepted prerequisites for promoting sustainable development. Macroeconomic stability characterized by low to moderate inflation and a competitive real exchange rate is important for growth. An institutional framework that promotes the rule of law and social stability, and encourages private sector investment and economic activity is essential for growth. Governments have an important role of providing or facilitating the provision of basic infrastructure and promoting the development and functioning of markets. Without effective governments economic policies will be distorted, fiscal deficits will be large and likely to cause inflation, and public expenditure will not be effectively utilized to improve the health and education of the poor and provide essential infrastructure. Effective governments are also required to develop a regulatory and taxation framework to protect the environment. Empirical research on determinants of growth has shown that investment and education are important factors in promoting growth. East Asian economies that had sustained growth for thirty years had high investment rates and high primary and secondary school enrollment rates. High investment rates require high domestic savings rates. Foreign savings can only supplement domestic savings but cannot be a driving force for financing the domestic investment required to support broad-based growth. Without an effective regulatory framework to protect the environment, high investment rates and growth can undermine the ecological integrity of a country.

Macroeconomic Stability in African Countries

After more than a decade of stabilization policies, many African countries have attained low rates of inflation. Annex table 7 shows that out of 49 Sub-Saharan African countries, at least 33 had single digit inflation rates in 1998. The CFA franc zone countries have traditionally had low rates of inflation because of anchoring their currencies to the French franc. This policy has, however, led to the overvaluation of the exchange rate before the 1994 devaluation. Uganda has remarkably reduced its inflation rate from a triple digit average during 1985-90 to single digit levels in 1995-98 without sacrificing growth. Exchange rate policies of most countries have removed distortions. By the end of 1998 at least 34 Sub-Saharan African countries — compared to three countries in 1985 — had accepted IMF Article VIII obligations that requires countries to remove foreign exchange restrictions on current account transactions. Most countries have unified their exchange rate and the parallel market premium has gone down to less than 10 per cent. Massive exchange rate overvaluation is no longer a common phenomenon among African countries.

Despite these huge improvements, most countries do not have a framework for maintaining macroeconomic stability. Budget deficits continue to be large even after including aid. Governments implementing IMF programs tend to use cash budgeting to control expenditures. Cash budgeting has reduced the financing of deficits by printing money. It has, however, been accompanied by an increase in debt payment arrears to domestic suppliers of goods and services and on non-Paris Club bilateral debt. Reliable and up to date estimates of budget deficits do not exist in most African countries because of large payment arrears for goods and services. Effective fiscal management is the main stumbling block for attaining macroeconomic stability. African governments need to both improve tax administration, in order to increase government revenue, and improve the allocation of government expenditure to focus on improving basic social services, including health and education, and upgrading infrastructure, particularly roads. Significant debt relief can be a catalyst to improve the management of public finances.

Investment Rates

Investment in physical capital is a necessary, though not a sufficient condition for a high growth rate of output. During 1960-92, all fast-growing East Asian countries had average annual investment rates of 20-30 per cent of GDP, measured in internationally comparable prices. Investment rates in African countries have been low. Ten countries, including Angola, Burundi, Chad, Ethiopia, Madagascar, Mozambique, Rwanda, Sierra Leone, Uganda and Zaire, had average annual investment rates of less than 5 per cent. Another 14 countries, including Benin, Burkina Faso, Cape Verde, Central African Republic, Congo, Gambia, Ghana, Guinea, Malawi, Mali, Niger, Somalia, and Tanzania, had investment rates of 5 to 10 per cent. The only countries with investment rates of around 20 per cent, similar to that of China, Hong Kong, Indonesia and Thailand, are some of the mineral exporting countries, including Botswana, Gabon, Namibia, South Africa and Zimbabwe. Surprisingly, Guinea-Bissau also had a relatively large share of its GDP invested. Only diamond rich Botswana had growth rates comparable to that of East Asia. Other countries with high rates of investment were unable to sustain high growth rates.

The cost of investment in Africa is very high compared to other countries. Investment as a share of GDP is significantly higher when computed in domestic prices than in internationally comparable prices. This is partly caused by over-pricing of imports to Africa and by corruption, which inflates costs of public sector investment projects. The high growth rate of African debt, which did not contribute to growth, is partly explained by the high cost of imported goods.

The low levels of investment rates are partly explained by low savings rates, as domestic savings usually finance a large share of domestic investment. The exception is initial capital-intensive mineral-related investment, which is usually foreign funded, but once production has started retained profits account for most of additional investment. The institutional arrangements and policy environment has not been conducive to promoting private investment. Inadequate provision and low quality of public goods, including effective administration of justice and dispute settlements, public infrastructure including roads, power and water supply and telecommunication, have discouraged private investment. Policy instability and changing rules of the game have discouraged private investment and promoted capital flight.

The main cause of high savings rates is high growth of income. Low savings rates in Africa is partly caused by poor growth performance. Another reason for low levels of domestic savings rates is the weak financial system. The financial institutions in most countries in the region have not been performing the role of effectively mobilizing savings and channeling resources to highly productive investment. In almost all countries, except South Africa, Mauritius and Zimbabwe, the financial sector is underdeveloped (both geographically and functionally), thin and shallow. It has been argued that financial systems were characterized by considerable 'financial repression' geared to the financing of budget deficits, directed credit allocation, and administrative setting of interest rates. Negative real interest rates, particularly on deposits, have been common in countries with moderate to high inflation rates.

The liberalization of financial markets was expected to lead to positive but low real interest rates, greater savings mobilization, a decrease in intermediation costs by lowering the spread between lending and deposit rates, an increase in the volume of credit to the private sector and an increase in the efficiency in credit allocation by selecting more productive investment projects.

Reform of the existing financial systems is necessary. However, the direction and scope of the reforms have been overly influenced by the 'financial repression' hypothesis and the empirically unverified assumption about the positive impact of financial liberalization in mobilizing savings and their more efficient allocation to more productive investment activities. In addition, the design of the financial sector reforms in Sub-Saharan Africa has not taken into consideration the historical realities of African countries that have been characterized by missing credit markets and the experience of countries that have succeeded in promoting sustained economic growth such as the East Asian tigers whose governments strived to create financial markets. Limited emphasis has been directed to creating an environment that promotes transparent private enterprises, and improving and standardizing accounting systems to facilitate information flows from private enterprises to financial institutions that could increase the number of bankable indigenous private enterprises.

Promoting domestic savings

African countries have very low and, in most cases, decreasing savings rates, particularly when compared to East Asian economies. Low per capita incomes are not a complete explanation of low rates of savings. Low per capita income in China and India is not associated with low and declining savings rates as in most of Sub-Saharan Africa. Economic stagnation and negative growth rates of per capita income has contributed to the low savings rates in Sub-Saharan Africa. Financial repression has been seen as a major cause of low savings rates in less developed countries. Empirical work that shows negative real interest rates are associated with low savings rates fail to distinguish between small and large repressions. Countries with large negative interest rates drive regression results that show significant positive elasticity of savings rates with respect to interest rates. When these countries are excluded from the sample, real interest rates lose statistical significance. It should be noted that high negative interest rates are the result of high inflation, a symptom of government failure not only to collect taxes and control expenditure, but also to deliver government services and maintain the rule of law. Where the government is excessively inefficient, savings rates and growth are likely to be low. In this situation, increasing nominal interest rates to make real interest rates positive is unlikely, by itself, to increase the savings rate and promote growth. High interest rates may exacerbate the financial position of weak governments because of increases in government debt servicing. Before using interest rates to promote savings, economic reforms should focus on improving government fiscal discipline.

African financial markets are highly fragmented where the majority of the population in rural areas and the informal urban sector has no access to financial services. If savings are to be effectively mobilized, financial services have to be extended to the population that is currently under served — which requires innovative ways of linking the formal and the informal financial sectors through encouraging the development of emerging semi-formal intermediaries.

Developing an efficient financial system is costly and takes time. There are large fixed costs associated with installing an information gathering and monitoring system. Moreover, monitoring a few large projects or borrowers costs less per dollar lent than monitoring many small projects. At low levels of development, when per capita incomes are low, the cost of developing financial institutions to finance small investors can be prohibitive. At initial stages of economic development, financial growth is likely to follow a breakthrough in initiating the process of economic development. Once the development process has been initiated the efficiency and growth of the financial infrastructure can accelerate the development process by increasing the savings rate through offering better services and attractive returns to savers, reducing risks by diversifying financial institutions' assets and debtors, improving intermediation efficiency by reducing the spread between the lending and savings rates, and through increases in the productivity of the capital stock by selecting more productive investment projects and better entrepreneurs. For latecomers in the development process financial markets do not develop spontaneously. They have to be created by supportive government policies. The emergence and expansion of a class of domestic borrowers is necessary for the growth of financial intermediation. Improvement in accounting systems and bookkeeping practices are a prerequisite for commercial banks to provide credit to firms. High tax rates have, in many cases, encouraged accounting practices that are geared to tax evasion rather than summarizing the true financial position of a firm. Tax policy reforms should not only focus on revenue mobilization but also on simplifying the tax code and improving accounting practices of commercial enterprises.

Financing African Investment Requirements

To initiate a poverty-reducing self-sustained growth process, Africa requires investment in physical and social infrastructure. Sub-Saharan Africa as a region has a poor physical and social infrastructure characterized by poor communication and transport systems, weak agricultural research and extension networks, limited telecommunication development and unreliable power and water supplies. Investment by the private sector, including foreign investment, is unlikely to flourish in countries with poor infrastructures even when the exchange rate is appropriate and relative prices are undistorted. Domestic savings, even when increased, will be inadequate to finance the required investment. There is no escape for the need for external financing of any realistic infrastructure investment program. Given the perceived political and economic instability in African countries, private financing of long term investment projects will simply not be available and hence the need for public sources of external funding.

The resource constraint of African countries is worsened by excessive and unpayable debt burdens. We should, however, not exaggerate the increase in resources resulting from debt relief, particularly given the high levels of debt payment arrears. Additional resources are only increased when the favored multilateral debt is cancelled. The cancellation of some of the bilateral debt such as that of Italy, Japan, and United States is more likely to offset new aid flows.

Investment in Education and Health

The new growth theory emphasizes the importance of human capital in promoting growth. Advocates of cancellation of poor countries' debt want the savings to be used to improve social services, particularly health and education. It is widely believed that sustained modern growth in real per capita income cannot be accounted for by the accumulation of conventional units of physical capital or by the increased application of hours of labour per capita. The source of modern growth is explained by changing quality of labour and capital, change in organization, policy environment or technology. All these factors are brought about or facilitated by a healthy and educated population. Investment in human capital empowers individuals to innovate, learn and adopt new technologies and effectively manage enterprises and other complex organizations. Also, educated individuals in democratic societies tend to be more conscious about the environment.

Adopting improved technologies for agricultural production requires a basic primary education of good quality that ensures functional literacy and numeracy. The education of girls is absolutely important for improving the health and care of children, family planning and a clean environment at home. In most African countries, primary education is not yet universal and widespread and adult illiteracy is common (Annex, table 8). Long-term development and social progress requires attaining and maintaining universal primary education. Only Botswana, Cape Verde, Lesotho, Mauritius, South Africa, Swaziland, Togo, Zambia and Zimbabwe have attained universal primary education. Education is, however, not only a means for attaining high growth, but also an end in itself for empowering individuals to live a more fulfilling life.

The productivity of individuals is also determined by their health and nutritional status. Since independence, infant mortality rates have decreased but are still very high. Life expectancy at birth is very low compared to East Asian countries. In some of the countries, including Botswana, Burundi, Central African Republic, Congo D R, Congo, Côte d'Ivoire, Ethiopia, Kenya, Malawi, Rwanda, Tanzania, Togo, Uganda, Zambia and Zimbabwe, life expectancy is falling mainly as a result of the scourge of AIDS. Public policy towards AIDS prevention is necessary for poverty reduction. Botswana's commendable improvements in human development has been eroded by AIDS with life expectancy falling by fifteen years in the last decade. Uganda has shown how active public policy can reduce the spread of the deadly disease. Some have argued that debt relief should be directed towards AIDS prevention.

The Role of Agriculture in Promoting Poverty Eradicating Growth

The main objective of economic reforms and adjustment policies must be to establish conditions for poverty-eradicating sustainable economic growth. Attaining a sustainable balance of payments deficit, low inflation, and a competitive exchange rate are important goals if and only if they contribute to economic growth and improvement in the living standards of the majority of Africans who are in poverty. Eradicating poverty in Africa is a long-term goal that requires immediate action. For African countries, it is inappropriate to design policies that focus on stabilization in the short run, adjustment in the medium-term and growth and poverty alleviation in the longer-term after attaining macroeconomic stability and adjusting relative prices. Stabilization and adjustment policies have to be designed in such a way that poverty-reducing growth is initiated.

There is a broad, though not universal, consensus among students of African economic development that a poverty-eradicating development strategy must be based on increasing productivity of smallholder agricultural producers and the promotion of small to medium labour intensive manufacturing enterprises. Economic growth and structural transformation of the economy depend on increasing labour productivity. Broad-based human resource development or investment in human capital is both an objective of development policy and an instrument for achieving sustainable growth.

It is generally agreed that the overall impact of government policies has led to the neglect of agriculture and direct and indirect taxation of African farmers. The World Bank has rightly criticized the high levels of direct and indirect taxation of the agricultural sector. To get the African agricultural sector moving, however, price incentives alone are not adequate. We need improvement in the rural infrastructure and effective research and extension and credit arrangement that will enable smallholder farmers to access appropriate productivity-increasing technologies. In the past two decades, both land and labour productivity have tended to decline while population is increasing at an average rate of 3 per cent – a rate that will double the population every 23 years. African countries will be condemned to permanent poverty if they do not address the problem of how to broadly increase agricultural productivity.

Smallholder farmers cultivating less than one hectare dominate African agriculture. Smallholder farmers are generally efficient producers given the nature of the agricultural production function and decision-making and the resource endowment of African countries. Yet agricultural productivity remains quite low relative to its potential given the existing level of global agricultural knowledge.

A rapid growth of agricultural incomes will stimulate the demand for manufactured goods and services. The growth of nonagricultural small-scale enterprises in rural areas, including the manufacturing activity of blacksmiths, tailors, carpenters, masons, repair shops, etc., depend on the dynamism of the agricultural sector. Domestic food intake is below the minimum recommended and lacks proteins and fats. Domestic demand for food, as incomes increase, can provide an additional stimulus for growth. Increasing specialization and commercialization of smallholder production will stimulate intra-regional trade and can initiate rapid growth in other sectors.

Agricultural progress and modernization is usually accompanied by increases in commercialization of agricultural production. To increase the use of off-farm products — inputs and final consumer goods and services — rural producers have to sell a larger share of their output. Rural infrastructure is indispensable. A broad-based agricultural development strategy also requires the development of rural infrastructure to connect rural producers to urban and world markets.

In many African countries the potential of rain-fed agriculture has not been exhausted. Improved marketing systems and price incentives have the potential of increasing output by fully utilizing the rural labour force and surplus land. The scope of increasing agricultural output in the long term by relying on improved marketing systems and price incentives is, however, limited even in countries with surplus agricultural land. Technical change that increases total factor productivity is necessary for transforming African agriculture. The collapse of real salaries, low budgetary allocation, lack of equipment, demoralization of scientists and lack of a clear research agenda further weakened African agricultural research capacity, which has never been adequate. Cooperation in agricultural research among African countries has tended to decrease. There is a backlog of agricultural technologies that are known and used in one country that could be utilized in neighbouring countries. Positive price incentives are important for encouraging farmers to invest and adopt more productive technologies as they become available. There is, however, no "Green Revolution" that has occurred without a government-supported system of credit allocation to encourage the adoption of better agricultural technology.

The main immediate problem facing an agricultural based development strategy is that world market prices of agricultural commodities, particularly tropical beverages, have collapsed. In a world of falling world market prices, liberalizing trade policies and depreciating the exchange rate are unlikely to maintain real positive price incentives. If all African countries try to increase their existing exports and attempt to capture their peak market shares and Asian countries continue to increase similar exports at current growth rates, export prices are bound to continue decreasing. The "fallacy of composition" is a real problem that in the real world is not resolved by the small country assumption. The World Bank and other aid agencies do not support international commodity agreements. The collapse of world market prices for tropical beverages have not led to a reduction of consumer prices but an increase in profits of food processing multinationals. International commodity arrangements that can guarantee some reasonable minimum producer prices can be useful in promoting agricultural transformation in African countries committed to supporting an agricultural-based development strategies. Industrialized countries are, however, unlikely to support such a strategy.

Diversification of agricultural exports should be a priority in any agricultural-based development strategy. Each country needs to put in place supporting policies and institutions that are necessary for a rapid increase in new exports of fruits and vegetables, oilseeds and nuts, fish products, flowers and exotic tropical plants based on smallholder producers.

Agricultural trade distorting practices of the US, Japan, and especially the European Union are not conducive for promoting agricultural exports. Non-tariff barriers, including health and sanitary standards, can be effectively used to limit trade opportunities of African countries. The Uruguay round has only slightly liberalized agricultural trade. Moreover, in the short run African exports will lose the special treatment they receive in the European Union when the preferences of the Lome Convention are phased out in the year 2000. The improvement of market access of African countries to developed country markets, including the capacity to meet sanitary standards, is essential for promoting broad-based development. Technical assistance may be useful.

The structural adjustment programmes tended to focus on macroeconomic stabilization, market liberalization and privatization. Comprehensive agricultural development strategies that focused on removing supply constraints facing African agriculture did not feature prominently in the Policy Framework Papers. The enhanced HIPC initiative is focusing on reallocating debt service savings into social sectors that have an impact on growth only in the longer term. The Poverty Reduction Strategy Papers that will replace Policy Framework Papers emphasize focus on monitorable social indicators. Policies to promote agricultural development, including improving rural infrastructure, can initiate growth and expand the tax base that can finance provision of social services. Increasing rural incomes can increase the capacity of the rural population to cover part of the cost of social services. An agricultural development strategy should feature prominently in African countries' Poverty Reduction Strategy Papers.

The Role of the State

> "*Much of the role of government can be viewed as establishing infrastructure in its broadest sense--educational, technological, financial, physical, environmental, and social. Because constructing the broad infrastructure is beyond the capacity or interest of any single firm, it must be primarily the responsibility of government*" (World Bank, 1999).

The development and poverty crisis in Africa is first and foremost the crisis of the African State. Most African governments have not fulfilled the traditional roles of maintaining law and order and providing a just legal framework under which households and private firms will produce and trade goods and services, investing in and maintaining physical and social infrastructure, and promoting agricultural research and extension. For most African countries with a rudimentary financial system, macroeconomic stability is essentially a fiscal phenomenon. At the aggregate level public sector deficits broadly defined to include public and quasi-public enterprises are the main domestic cause of balance of payments problems, the external debt crisis and inflation. The IMF stabilization programmes tended to emphasize short-term reduction of deficits by reducing aggregate expenditures or increasing government revenue. Raising government revenue in a sustainable way, without discouraging savings and promoting investment, was not part of the earlier IMF stabilization programmes. Prioritizing government expenditure and respecting the budget constraint is an essential characteristic for promoting poverty-reducing growth.

To reduce poverty and promote growth requires a government bureaucracy of high quality that has to put in place efficient tax and expenditure systems that minimize inefficient and unproductive spending. The first priority of a government seriously committed to promoting sustainable development may well be to improve the quality of the public institutions so that it can pursue the objective of poverty-reducing growth in the most efficient way. The task of improving the quality of government can be formidable. Synergy and *espirit de corp* is important in public institutions because they work together. The objective of poverty reduction cannot be attained if there is an efficient tax revenue institution but expenditure departments do not function well. Broad improvements in all critical institutions of governance are necessary for overall improvements in the quality of government. A comprehensive approach that addresses problems of different institutions of governance, including the judiciary, police, tax administration and expenditure departments at the same time, may be necessary before embarking on a poverty-reducing strategy.

Effective public expenditure management requires that "the total amount of money a government spends should be closely aligned to what is affordable over the medium term and, in turn, with the annual budget; such spending should be appropriately allocated to match policy priorities; and the spending should produce its intended results at least cost" (World Bank, 1999b). Undisciplined fiscal policy has adverse consequences on the poor. Budgetary allocation on priority areas for the poor will not be adequate. Improvements in public expenditure management need a focus on efficiency, the results achieved with expenditure. Government budgets should be the product of policy choice and planning. If the policy choice is sustainable poverty reduction, the whole government budget should reflect this choice and not just expenditure of funds released from debt relief.■

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ANNEX

Table 1. Trend growth rate of total debt stock and exports of goods and services

	1971-1980		*1980-90*		*1990-97*	
Country	*Debt*	*Exports*	*Debt*	*Exports*	*Debt*	*Exports*
Angola	….	…	23.8	15.0	2.9	4.8
Benin	30.7	15.6	11.4	5.1	3.8	2.0
Botswana	12.7	27.1	16.1	15.5	0.5	2.5
Burkina Faso	41.5	20.5	11.8	4.7	6.3	-2.1
Burundi	43.6	…	21.1	…	2.8	-3.6
Cameroon	37.8	20.3	10.0	2.3	5.8	-0.7
Cape Verde	79.3	30.2	17.8	6.8	8.9	10.7
Central African Republic	23.1	15.5	15.6	2.0	3.5	1.3
Chad	29.8	-19.0	7.3	14.6	9.7	2.3
Comoros	58.8	…	16.9	12.1	1.7	1.2
Congo, Dem. Rep.	32.1	12.1	8.6	3.3	3.4	-4.0
Congo, Rep.	30.8	…	13.9	0.5	1.6	3.2
Côte d'Ivoire	34.7	18.8	8.5	1.5	-0.4	6.3
Djibouti	30.8	…	25.4	…	5.1	-1.4
Equatorial Guinea	21.4	…	12.0	…	2.6	34.2
Eritrea	…	…	…	…	35.6	9.0
Ethiopia	17.5	10.8	21.9	2.5	2.3	8.5
Gabon	31.6	…	14.8	-3.1	1.3	3.5
Gambia, The	42.0	…	9.5	10.3	2.5	1.6
Ghana	11.3	6.8	11.7	1.6	6.9	9.2
Guinea	11.2	…	8.0	…	5.1	-1.5
Guinea-Bissau	71.5	…	19.1	…	4.5	17.2
Kenya	22.9	14.0	8.4	1.4	-0.9	5.9
Lesotho	28.2	18.4	18.1	2.9	8.3	2.3
Liberia	19.4	…	10.6	…	1.6	…
Madagascar	3.8	9.5	11.4	1.1	1.7	8.9
Malawi	21.2	14.7	7.3	2.2	6.1	2.9
Mali	11.7	21.9	13.8	7.4	2.4	3.6
Mauritania	43.0	4.9	9.9	6.0	2.4	0.0
Mauritius	37.5	14.0	7.2	14.7	14.1	6.5
Mozambique		…	9.2	…	3.9	9.0
Niger	41.9	33.3	7.7	-0.1	-0.4	-7.4
Nigeria	26.6	30.3	14.0	-8.4	-1.1	3.4
Rwanda	70.7	13.9	16.5	-0.6	6.1	-3.3
Sao Tome and Principe	…	18.4	19.9	-5.9	8.4	3.2
Senegal	30.7	5.7	10.8	4.7	0.1	1.2
Seychelles	…	29.1	14.6	10.2	-1.7	6.1
Sierra Leone	18.0	18.8	9.2	-1.2	-0.3	-10.9
Somalia	27.8	34.9	11.3	…	1.5	…
South Afica	…	…	…	…	4.9	…
Sudan	35.3	13.5	10.2	-3.2	2.1	10.7
Swaziland	24.7	10.8	3.7	6.3	2.8	6.0
Tanzania	18.1	4.4	0.1	-3.6	2.1	17.4
Togo	50.0	17.3	3.1	3.3	1.5	0.0
Uganda	17.5	3.6	14.7	-1.3	5.7	25.9
Zambia	17.8	4.8	9.4	0.0	-0.8	0.5
Zimbabwe	13.1	19.3	11.6	2.3	6.8	8.2

Source: Computed using data from World Bank Global Development Finance 1999 CD Rom

Table 2: Total arrears on LDOD Percentage of Exports

Country	*1975*	*1980*	*1985*	*1990*	*1994*	*1995*	*1996*	*1997*
Angola	...	...	1.8	17.5	153.9	140.8	32.6	34.9
Benin	10.1	5.9	43.8	19.7	16.7	12.9	12.7	13.1
Botswana	0.0	0.0	0.0	0.2	0.9	0.5	0.0	...
Burkina Faso	0.0	0.1	4.2	16.8	12.9	11.5	11.1	6.8
Burundi	...	...	5.7	0.1	12.2	3.5	34.9	35.4
Cameroon	0.3	0.9	2.1	23.1	45.5	48.4	68.4	26.8
Cape Verde	...	0.0	0.7	11.8	17.8	16.8	18.8	16.1
Central African Republic	...	26.3	2.0	17.3	46.6	47.4	63.8	65.8
Chad	...	52.8	59.9	8.0	25.8	14.3	16.0	13.1
Comoros	...	0.0	9.3	78.5	49.7	56.8	69.1	68.0
Congo, Dem. Rep.	9.0	2.8	15.7	50.8	417.9	424.7	428.8	521.0
Congo, Rep.	...	1.4	13.8	50.1	103.2	117.8	78.1	88.6
Côte d'Ivoire	0.0	0.0	2.2	71.5	98.1	81.8	68.4	4.7
Djibouti	...	...	...	...	5.8	7.8	8.4	11.6
Equatorial Guinea	...	...	...	113.7	167.4	144.2	73.9	29.8
Eritrea	...	...	...	...	0.0	0.0	0.0	0.0
Ethiopia	0.1	0.2	0.3	41.2	569.1	503.6	581.1	506.2
Gabon	...	0.0	0.0	7.7	6.2	0.9	0.0	0.0
Gambia, The	...	0.5	22.4	0.8	2.9	2.2	0.1	0.1
Ghana	6.1	0.8	6.5	13.3	10.6	7.3	2.1	1.6
Guinea	...	...	...	29.1	83.0	63.5	56.1	75.6
Guinea-Bissau	...	...	206.1	703.0	931.6	1422.2	782.9	391.8
Kenya	0.0	0.3	0.9	7.5	3.5	1.3	1.5	3.6
Lesotho	0.0	0.0	0.1	0.8	2.9	2.2	2.2	1.8
Liberia	...	0.8	38.7	...	...	...	...	...
Madagascar	0.2	3.2	24.4	79.4	209.6	220.3	216.4	95.5
Malawi	...	1.3	0.6	5.7	4.1	2.0	3.8	4.5
Mali	33.1	23.6	32.4	13.1	56.9	56.9	70.0	78.1
Mauritania	0.4	19.7	15.1	41.9	61.1	49.5	48.7	63.0
Mauritius	...	0.4	0.0	0.4	0.1	0.0	0.0	0.0
Mozambique	...	...	166.1	310.9	266.8	284.0	237.3	248.1
Niger	0.4	0.2	2.7	19.6	22.9	38.0	23.5	31.1
Nigeria	...	0.0	1.8	14.4	92.4	96.8	79.6	83.2
Rwanda	...	0.0	0.0	6.5	134.0	64.2	85.3	58.7
Sao Tome and Principe	0.0	0.0	31.3	341.2	355.0	335.4	205.2	174.0
Senegal	0.0	0.0	2.2	0.0	19.4	4.4	0.9	0.8
Seychelles	...	0.0	0.0	4.4	8.0	8.1	7.8	7.5
Sierra Leone	...	8.5	51.2	168.2	27.4	15.5	18.5	24.2
Somalia	...	8.1	147.5	...	...	...	...	...
South Africa	...	...	...	...	0.0	0.0	0.0	0.0
Sudan	0.0	58.4	186.3	1414.8	1698.7	1203.6	1352.6	1157.4
Swaziland	0.0	0.0	0.0	0.0	0.7	0.5	0.1	0.1
Tanzania	...	270.3	1206.5	223.2	215.7	186.7	178.0	144.2
Togo	0.3	8.4	0.1	0.6	45.4	14.0	12.4	0.7
Uganda	1.7	30.4	14.6	121.3	83.8	39.0	33.7	28.8
Zambia	0.2	2.4	63.2	169.2	166.8	72.5	82.7	70.3
Zimbabwe	...	0.0	0.0	0.0	0.9	0.9	0.1	0.0

Source: World Bank Global Development Finance 1999 CD Rom

Table 3: Recent Three IMF Programs

Country Name	*IMF Program Type*	*Approval Date*	*Expiration Date*	*Amount Approved (SDR Million)*	*Amount Drawn (SDR Million)*
Angola	None				
Benin	ESAF	08/28/1996	01/07/2000	27.18	16.31
	ESAF	01/25/1993	05/21/1996	51.89	51.89
	SAF	06/16/1989	06/15/1992	21.91	15.65
Botswana	None				
Burkina Faso	ESAF	09/10/1999	09/09/2002	39.12	5.59
	ESAF	06/14/1996	09/09/1999	39.78	39.78
	ESAF	03/31/1993	05/30/1996	53.04	44.20
Burundi	ESAF	11/13/1991	11/12/1994	42.70	19.21
	SAF	08/08/1986	08/07/1989	29.89	29.89
	Stand-by	08/08/1986	03/31/1988	21.00	0.00
Cameroon	ESAF	08/20/1997	08/19/2000	162.12	126.09
	Stand-by	09/27/1995	09/26/1996	67.60	28.20
	Stand-by	03/14/1994	09/13/1995	81.06	21.91
Cape Verde	Stand-by	02/20/1998	12/31/1999	2.50	0.00
Central African Republic	ESAF	07/20/1998	07/19/2001	49.44	16.48
	Stand-by	03/28/1994	03/27/1995	16.48	10.71
	SAF	06/01/1987	05/31/1990	21.28	21.28
Chad	ESAF	09/01/1995	04/30/1999	49.56	49.56
	Stand-by	03/23/1994	03/22/1995	16.52	10.33
	SAF	10/30/1987	10/29/1990	21.42	21.42
Comoros	SAF	06/21/1991	06/20/1994	3.15	2.25
Congo, Dem. Rep.	Stand-by	06/09/1989	06/08/1990	116.40	75.00
	SAF	05/15/1987	05/14/1990	203.70	145.50
	Stand-by	05/15/1987	05/14/1988	100.00	24.50
Congo, Rep.	ESAF	06/28/1996	06/27/1999	69.48	13.90
	Stand-by	05/27/1994	05/26/1995	23.16	12.50
	Stand-by	08/27/1990	05/26/1992	27.98	4.00
Côte d'Ivoire	ESAF	03/17/1998	03/16/2001	285.84	123.86
	ESAF	03/11/1994	06/13/1997	333.48	333.48
	Stand-by	09/20/1991	09/19/1992	82.75	33.10
Djibouti	Stand-by	04/15/1996	03/31/1999	8.25	7.27
Equatorial Guinea	ESAF	02/03/1993	02/02/1996	12.88	4.60
	SAF	12/07/1988	12/06/1991	12.88	9.20
	Stand-by	06/28/1985	06/27/1986	9.20	5.40
Eritrea	None				
Ethiopia	ESAF	10/11/1996	10/22/1999	88.47	29.49
	SAF	10/28/1992	11/08/1995	49.42	49.42
	Stand-by	05/08/1981	06/30/1982	67.50	67.50
Gabon	EFF	11/08/1995	03/07/1999	110.30	60.67
	Stand-by	03/30/1994	03/29/1995	38.60	38.60
	Stand-by	09/30/1991	03/29/1993	28.00	4.00

Table 3. (continued)

Country	*IMF Program Type*	*Approval Date*	*Expiration Date*	*Amount Approved (SDR Million)*	*Amount Drawn (SDR Million)*
Gambia, The	ESAF	06/29/1998	06/28/2001	20.61	3.44
	ESAF	11/23/1988	11/25/1991	20.52	18.02
	SAF	09/17/1986	11/22/1988	10.86	8.55
Ghana	ESAF	05/03/1999	05/02/2002	155.00	22.16
	ESAF	06/30/1995	05/02/1999	164.40	137.00
	ESAF	11/09/1988	03/05/1992	388.55	388.55
Guinea	ESAF	01/13/1997	01/12/2000	70.80	47.20
	ESAF	11/06/1991	12/19/1996	57.90	46.32
	SAF	07/29/1987	07/28/1990	40.53	28.95
Guinea-Bissau	ESAF	01/18/1995	07/24/1998	10.50	10.50
	SAF	10/14/1987	10/13/1990	5.25	3.75
Kenya	ESAF	04/26/1996	04/25/1999	149.55	24.93
	ESAF	12/22/1993	12/21/1994	45.23	45.23
	ESAF	05/15/1989	03/31/1993	261.40	216.17
Lesotho	Stand-by	09/23/1996	09/22/1997	7.17	0.00
	Stand-by	07/31/1995	07/30/1996	7.17	0.00
	Stand-by	09/23/1994	07/31/1995	8.37	0.00
Liberia	Stand-by	12/07/1984	12/06/1985	42.78	8.50
	Stand-by	09/14/1983	09/13/1984	55.00	55.00
	Stand-by	09/29/1982	09/13/1983	55.00	35.00
Madagascar	ESAF	11/27/1996	07/27/2000	81.36	40.68
	ESAF	05/15/1989	05/14/1992	76.90	51.27
	Stand-by	09/02/1988	05/15/1989	13.30	2.80
Malawi	ESAF	10/18/1995	10/31/1999	50.96	43.33
	Stand-by	11/16/1994	06/30/1995	15.00	12.73
	ESAF	07/15/1988	03/31/1994	66.96	66.96
Mali	ESAF	08/06/1999	08/05/2002	46.65	6.75
	ESAF	04/10/1996	08/05/1999	62.01	62.01
	ESAF	08/28/1992	04/09/1996	79.24	79.24
Mauritania	ESAF	07/21/1999	07/20/2002	42.49	6.07
	ESAF	01/25/1995	07/13/1998	42.75	42.75
	ESAF	12/09/1992	01/24/1995	33.90	33.90
Mauritius	Stand-by	03/01/1985	08/31/1986	49.00	49.00
	Stand-by	05/18/1983	08/17/1984	49.50	49.50
	Stand-by	12/21/1981	12/20/1982	30.00	30.00
Mozambique	ESAF	06/28/1999	06/27/2002	58.80	8.40
	ESAF	06/21/1996	06/27/1999	75.60	75.60
	ESAF	06/01/1990	12/31/1995	130.05	115.35
Namibia	None				
Niger	ESAF	06/12/1996	08/27/1999	57.96	48.30
	Stand-by	03/04/1994	03/03/1995	18.60	11.11
	ESAF	12/12/1988	12/11/1991	47.18	23.59

Table 3. (continued)

Country	*IMF Program Type*	*Approval Date*	*Expiration Date*	*Amount Approved (SDR Million)*	*Amount Drawn (SDR Million)*
Nigeria	Stand-by	01/09/1991	04/08/1992	319.00	0.00
	Stand-by	02/03/1989	04/30/1990	475.00	0.00
	Stand-by	01/30/1987	01/31/1988	650.00	0.00
Rwanda	ESAF	06/24/1998	06/23/2001	71.40	23.80
	SAF	04/24/1991	04/23/1994	30.66	8.76
	Stand-by	10/31/1979	10/30/1980	5.00	0.00
Senegal	ESAF	04/20/1998	04/19/2001	107.01	49.94
	ESAF	08/29/1994	01/12/1998	130.79	130.79
	Stand-by	03/02/1994	08/29/1994	47.56	30.91
Seychelles	None				
Sierra Leone	ESAF	03/28/1994	05/04/1998	101.90	96.85
	SAF	03/28/1994	03/27/1995	27.02	27.02
	SAF	11/14/1986	11/13/1989	40.53	11.58
Somalia	SAF	06/29/1987	06/28/1990	30.94	8.84
	Stand-by	06/29/1987	06/28/1988	33.15	5.53
	Stand-by	02/22/1985	09/30/1986	20.10	20.10
South Africa	Stand-by	11/03/1982	12/31/1983	364.00	159.00
Sudan	Stand-by	06/25/1984	06/24/1985	90.00	20.00
	Stand-by	02/23/1983	03/09/1984	170.00	170.00
	Stand-by	02/22/1982	02/21/1983	198.00	70.00
Swaziland	None				
Tanzania	ESAF	11/08/1996	02/07/2000	181.59	181.59
	ESAF	07/29/1991	07/28/1994	181.90	85.60
	SAF	10/30/1987	10/29/1990	74.90	74.90
Togo	ESAF	09/16/1994	06/29/1998	65.16	54.30
	ESAF	05/31/1989	02/28/1993	46.08	38.40
	SAF	03/16/1988	05/30/1989	26.88	7.68
Uganda	ESAF	11/10/1997	11/09/2000	100.43	73.65
	ESAF	09/06/1994	11/09/1997	120.51	120.51
	ESAF	04/17/1989	06/30/1994	219.12	219.12
Zambia	ESAF	03/25/1999	03/24/2002	254.45	10.00
	ESAF	12/06/1995	12/05/1998	701.68	661.68
	SAF	12/06/1995	12/05/1996	181.75	181.75
Zimbabwe	Stand-by	08/02/1999	10/01/2000	141.36	24.74
	Stand-by	06/01/1998	06/30/1999	130.65	39.20
	EFF	09/11/1992	09/10/1995	114.60	86.90

Source: Country Information in www.imf.org

Table 4. Principal and interest forgiven 1985-97
(per cent of total debt)

Country Name	*1985*	*1997*	*Country Name*	*1985*	*1997*
Angola	125.3	36.9	Liberia	0.3	0.2
Benin	53.4	28.1	Madagascar	35.5	21.9
Botswana	1.3	0.8	Malawi	7.3	3.4
Burkina Faso	70.6	27.8	Mali	35.1	17.4
Burundi	31.2	13.3	Mauritania	16.0	9.5
Cameroon	28.5	9.7	Mauritius	0.5	0.1
Cape Verde	9.2	4.1	Mozambique	32.2	15.5
Central African Republic	71.9	27.9	Niger	44.0	33.3
Chad	81.4	17.2	Nigeria	0.2	0.2
Comoros	35.7	24.3	Rwanda	18.0	5.9
Congo, Dem. Rep.	9.1	4.6	Sao Tome and Principe	0.0	0.0
Congo, Rep.	11.1	6.7	Senegal	51.8	36.2
Cote d'Ivoire	21.0	13.0	Seychelles	0.0	0.0
Djibouti	31.0	15.7	Sierra Leone	32.2	19.9
Equatorial Guinea	15.0	7.0	Somalia	7.9	5.0
Eritrea	…	0.0	South Africa	…	0.0
Ethiopia	4.0	2.1	Sudan	0.9	0.5
Gabon	26.2	7.4	Swaziland	0.4	0.3
Gambia, The	4.7	2.7	Tanzania	15.4	19.5
Ghana	16.8	6.3	Togo	39.9	27.9
Guinea	31.3	13.0	Uganda	14.2	4.7
Guinea-Bissau	16.2	5.6	Zambia	27.8	18.8
Kenya	17.7	11.4	Zimbabwe	2.3	1.1
Lesotho	7.0	1.8	Sub Sahara Africa	18.3	8.9

Source: World Bank Global Development Finance 1999 CD Rom

Table 5. Gross net transfers as a percentage of GNP

Country	*1970-74*	*1975-79*	*1980-84*	*1985-89*	*1990-94*	*1995-97*	*1996*	*1997*
Angola	…	…	…	12.3	11.6	-3.8	-12.0	-11.2
Benin	4.0	7.8	10.1	7.3	11.8	8.6	8.9	6.3
Botswana	20.7	12.8	5.0	-3.5	-7.2	-5.7	-6.5	-5.7
Burkina Faso	5.8	7.8	9.5	8.5	13.4	11.5	11.6	9.7
Burundi	4.2	6.6	10.3	10.7	19.2	18.4	20.0	10.4
Cameroon	4.0	7.8	3.6	0.0	4.0	-0.4	0.0	-0.2
Cape Verde	…	…	50.1	36.4	22.6	21.5	22.6	20.6
Central African Re-	7.7	7.9	10.3	10.3	11.4	11.1	13.5	7.7
Chad	5.9	9.7	7.8	15.8	14.0	12.8	14.1	11.0
Comoros	17.2	25.6	30.3	21.2	12.5	10.7	10.9	8.6
Congo, Dem. Rep.	3.5	4.3	-0.3	2.3	3.8	1.7	1.8	1.2
Congo, Rep.	18.0	12.8	16.5	2.2	2.7	2.1	-0.6	9.3
Cote d'Ivoire	2.7	6.0	-0.5	-4.1	3.2	1.0	2.7	-4.4
Djibouti	…	…	…	…	…	10.8	11.7	9.1
Equatorial Guinea	7.2	…	…	31.0	36.4	90.9	172.1	6.6
Eritrea	…	…	…	…	…	13.2	12.6	10.8
Ethiopia	…	…	…	11.6	16.5	7.9	6.2	7.6
Gabon	13.4	3.8	-7.4	5.4	-4.1	-10.1	-9.8	-11.2
Gambia, The	6.1	12.2	22.4	28.1	17.0	11.0	17.6	8.7
Ghana	1.5	1.6	2.4	6.4	13.0	11.2	12.1	7.7
Guinea	…	…	…	…	7.6	5.8	5.4	5.5
Guinea-Bissau	0.6	36.3	48.7	48.3	32.1	28.1	29.5	29.7
Kenya	3.7	3.5	3.0	4.5	4.0	-1.1	-1.6	-2.3
Lesotho	8.2	6.6	10.0	10.9	8.6	6.4	6.3	5.3
Liberia	-1.3	9.8	11.6	…	…	…	…	…
Madagascar	3.9	2.8	7.8	7.0	10.8	11.7	7.4	20.2
Malawi	9.1	12.5	6.7	12.3	18.8	15.9	13.3	8.1
Mali	11.9	11.7	16.1	16.3	11.6	11.7	10.7	10.9
Mauritania	9.3	22.4	23.5	15.8	16.2	16.9	22.2	13.8
Mauritius	1.7	3.7	2.4	2.5	1.1	6.9	0.6	14.6
Mozambique	…	…	…	31.6	51.5	37.6	31.3	28.0
Niger	6.3	11.8	9.0	11.2	12.7	9.7	8.0	12.8
Nigeria	-2.8	0.1	-0.2	-1.9	-3.2	-0.9	-2.1	0.8
Rwanda	6.0	9.4	7.5	7.4	25.7	37.9	41.3	27.1
Sao Tome and Prin-	…	13.9	37.9	43.7	84.7	66.1	65.8	38.4
Senegal	4.5	4.5	10.6	6.9	9.8	6.6	6.2	6.6
Seychelles	20.4	14.8	13.6	10.2	4.3	5.0	4.1	6.8
Sierra Leone	4.1	2.6	2.4	4.7	12.2	12.1	11.2	11.9
Somalia	8.9	28.0	54.1	33.7	…	…	…	…
South Africa	…	…	…	…	…	0.9	-0.9	0.8
Sudan	3.1	7.4	11.0	4.9	5.5	2.3	2.3	1.6
Swaziland	-2.8	10.2	1.3	-2.5	-3.3	-3.5	-5.3	-0.6
Tanzania	…	…	…	…	18.4	9.4	8.0	9.1
Togo	1.7	21.9	4.9	6.2	7.2	8.0	9.5	4.5
Uganda	…	…	8.4	5.7	14.7	10.3	9.5	10.1
Zambia	-1.9	5.4	6.2	14.9	17.5	9.1	9.0	7.8
Zimbabwe	-0.5	0.8	2.9	-0.5	3.9	1.5	0.6	0.4

Source: World Bank Global Development Indicators, 1999

INCREASING THE CONTRIBUTION OF FOREIGN INVESTMENT TO SUSTAINABLE DEVELOPMENT: DOMESTIC AND INTERNATIONAL POLICY MEASURES

John R. Dilyard
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EXECUTIVE SUMMARY

The developing world consists of two relatively clearly defined groups of countries: those which are growing at a sustainable rate, albeit with interruptions caused by short-term dislocations (industrializing/developing) and those whose performance is close to stagnation (poor countries). This distinction reinforces the observation of the Commission on Sustainable Development (CSD) that "poverty elimination" had become the "poor step-child" of the annual CSD sessions. The paper addresses an important aspect of the problem: can the inadequacy of official development assistance to nations in need of external finance be remedied by private portfolio and direct investment and, if so, what are the necessary policy measures for both the investing and recipient nations?

The policies will hinge on the adequacy of the institutions needed by both the more developed countries and poorer countries if they are both to attract and retain inward flows of private portfolio equity investment and to avoid financial crises.

The need for external finance derives from the low level of domestic savings and, possibly, the inability to generate export revenues to meet the developmental need for hard currency. Private investments, direct and portfolio, are possible sources of the needed finance. Neither direct nor portfolio investment is likely to be available to the developing countries in the amount needed because of inadequate resource bases and/or an inadequate "institutional infrastructure" and because of inadequate supplies of savings being generated in the consumer-driven economies of the industrialized world. Further, part of the supply of finance potentially available to the developing countries has been siphoned off by the needs of countries with economies in transition.

There is good reason to consider under-emphasis on poverty as a serious omission if, as seems reasonable, very poor countries will almost inevitably tend to devote any increase in available resources to consumption and to investment which generates consumption goods rather than to the other goals of Sustainable Development ("environmental protection and the creation of biodiversity" and "social programmes"). Failure of the participants in the Rio Summit to officially acknowledge and to repair the inadequacy of financing available to the very poor countries is a major concern.

In a globalized economic system with a liberalized international economic involvement, developmental strategy requires that nations seeking sustainable development take advantage of the benefits of international trade and investment by following a policy of outward industrialization allowing inflows and outflows of direct investment and utilizing portfolio finance where this is expected to be long-term. This paper addresses two sources of private foreign financing, direct investment and portfolio investment. The paper can be seen as validating Jun and Brewer (1997) in the greater contribution of direct investment to sustainable development, but it also shows the inadequacy of heavy reliance on the corporate sector because these channels of funding together will fail to eliminate the inadequacy of external funding, particularly for poor countries. The paper also examines why this should be so, and what steps must be taken if either direct and/or private portfolio investment are to be relied upon to eliminate the funding "gap" between the available flow and the amount which could be used efficiently.

It is necessary to recognize the need for developing countries to have sophisticated institutional infrastructure if they are to rely on private funds for financing sustainable development. In poor countries, such sophistication is probably not feasible because the ability to create the "institutional financial infrastructure" needed to

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attract private portfolio investment is acquired only as part and parcel of the process of the institutional evolution that is endemic in sustainable development. Middle-income or industrializing/development countries can benefit greatly from inflows of direct investment and, if they have developed or can develop the appropriate financial infrastructure, from inflows of modern portfolio investment.

THE United Nations Commission on Sustainable Development recognizes the sovereignty of individual developing nations as well as the three goals of eliminating poverty;[1] the development of social programs; and the importance of limiting environmental degradation while recognizing the dangers of reductions in biodiversity. Developing nations have, therefore, the acknowledged right to allocate such economic gains as they may achieve according to their own set of priorities. The priorities among the goals will vary according to the level and rate of growth of income of individual countries and their cultures. It may also be reasonably assumed that the lower the level of per-capita gross domestic product, the greater will be the share of any incremental product that will be devoted to consumption (the elimination of poverty) and the smaller the share for the other goals identified by the Rio Summit.

Modern conditions divide the developing world into two relatively clearly defined groups of countries: those which are growing at a sustainable rate, albeit with interruptions caused by short-term dislocations (industrializing-developing or I-D countries) and those whose performance is close to stagnation (poor countries). The 1996 Human Development Report (UNDP, 1996, 3) identifies 101 countries (not including China or India but with 25 per cent of the world's population) as suffering from "failed growth," defined as having per-capita income lower in 1993 than before 1990. Boote and Thugge (1997, table 2) identify 41 heavily-indebted poor countries which stand in drastic need of debt relief.

The existence of such a large share of the world's population in countries with failed growth is both an important moral problem for the civilized world in the light of the goals agreed upon at the Rio Summit and offers the possibility of substantial damage to the global commons as poor countries are likely to commit large amounts of environmental damage in their search for greater product.[2] Given this scenario, the distribution of income gains and sustainable development among the population of developing countries has significant importance for the global benefits to be derived from the reduction of pollution spillovers. It is, therefore, important that the Commission on Sustainable Development address the foreign financing of economic development in the non-industrialized world as well as the conditions in the recipient countries necessary for such financing.

Investment in I-D and poor countries works its effect mainly by augmenting the rate of economic growth and by contributing to any evolution in the host economy that accompanies economic growth. Portfolio investment, unless it incorporates foreign expertise and training related to a specific project, will serve to supplement domestic savings so that the rate of capital formation can be increased and, possibly, to ease any shortage of foreign exchange needed for the acquisition of foreign-made capital goods. Foreign direct investment (FDI) is likely to include technology transfer, foreign expertise and training of indigenous personnel, as well as a supplement to domestic savings. Access to foreign markets may also be generated when the affiliate is incorporated into a global network of production and distribution. The emphasis on economic growth leaves, as noted above, the partition of the economic gains among the three goals of the Rio Summit to the individual nation. This does not preclude some spillover gains to limiting environmental degradation and to the creation of social programs. The degree to which such spillover effects are generated will depend to a large degree on the concern of the multinational corporation with the aspirations of the host country there will be wide variability among multinationals.

Jun and Brewer (1997) noted that the top twelve recipient nations (including China, which we would contend is unique) receive about 80 per cent of FDI flows as well as a substantial part of private portfolio flows. These data reinforce the suggestion that the

[1] The Commission on Sustainable Development cited, as a criticism of progress reports, that "poverty elimination" had become the "poor stepchild" of the annual CSD sessions *(CSD Update*, vol. 3, November, 1996).

[2] Damage to the environment committed by very poor nations has different characteristics than the damage perpetrated by the industrialized nations and the richer developing nations. The decimation of the rainforests of the Amazon basin and the generation of carbon monoxide from petroleum consumption are obvious examples of the two kinds.

developing countries have been effectively divided into two blocs and that the more affluent developing countries enjoy a virtuous cycle of self-reinforcing development while the poor countries suffer a vicious cycle of self-reinforcing stagnation.

The purpose of this paper is to examine the way in which private capital flows are attracted to developing countries so that savings can be transferred from the developed countries in the form of direct and private portfolio investment flows to I-D and poor countries. Given that the Rio Summit relied upon the corporate sector to be the key actor in the "battle to save the planet" (Ismail, 1996), the role of private financial transfers and their distribution between the two groups of developing countries must constitute a primary area of focus. The paper identifies the adequacy or inadequacy of "institutional infrastructure" as an important factor affecting the ability of a developing nation to attract (and to retain) inward investment. Institutional infrastructure comprises the institutional setting, the rules and regulations and the efficiency of their enforcement that prevail in a country.[3] Inward private portfolio investment, particularly portfolio equity investment (modern foreign portfolio investment or MFPI) is extremely sensitive to the adequacy of "financial institutional infrastructure".

THE ROLE OF PRIVATE CAPITAL IN SUSTAINABLE DEVELOPMENT

All developing countries need to attract a flow of net inward foreign investment in some form and for an extended period as a supplement to domestic savings during the process of development.[4] Thus, a nation must be able to generate inflows of foreign funds in the form of direct investment, traditional private and official portfolio investment, modern portfolio investment (denominated in host-country currency — see below) or official development assistance (ODA) to supplement its sustainable development initiatives.

The financing of sustainable development must confront three problems: first, the adequacy of the total flow of available funds (the actual or potential flow relative to the amount which can be effectively and efficiently used);[5] second, the distribution of these funds among the two groups in the developing world; and third, the ability of the developing countries to avoid financial or environmental crises in which the direction of the flow of funds reverses and net capital flows return to the industrialized world.

In the absence of a substantial increase in ODA and other subsidized flows, the flow of private capital from the industrialized to the developing world is likely to be less than the perceived need of the developing countries. Since private capital seeks high risk-adjusted rates of return, global excess demand for savings can lead to competition among developing countries to attract inflows of investment and to turn the terms of trade against developing countries and in favour of multinational corporations and industrialized nations with surplus savings.[6] Even if the total foreign savings available for transfer to developing countries were, in some sense, adequate, it is probable that its distribution would be biased towards the I-D countries. It is therefore possible to perceive of a quasi-optimistic scenario in which the I-D countries do receive (almost) as much private investment as they can effectively utilize — largely in the form of FDI and portfolio capital — while poor countries continue to be underfunded.

The major problems facing poor countries are the lack of a policy framework that favours inward FDI, institutional infrastructure that allows FDI to be used effectively, the resources needed to attract inward FDI (Dunning and Narula, 1996) and the lack of financial infrastructure or the sophistication necessary to attract private portfolio capital even if the greater benefit allows a risk premium to be paid. I-D countries, however, may have local resources of sufficient quality to attract inward FDI and they may have financial infrastructure which is adequate to attract inward private portfolio investment under tranquil conditions but not adequate to retain inward portfolio investment in turbulent times.

Not all components of the gross inflow are equally valuable per unit of inflow. What matters is that they accumulate to the amount which the country can use effectively; there is, therefore, substantial substitutability among the different components.

[3] The concept is developed below. Institutional infrastructure must be clearly distinguished from "physical" infrastructure whose role in development is well recognized. The two types of infrastructure have features in common and some aspects, such as the existence of good communications networks, might be classified in either category.

[4] This is an assumption which could be disproved by reference to the remarkable success of Taiwan, Province of China, which has run current account surpluses and has a substantial positive balance of foreign assets owned over liabilities to foreigners. This example is more honoured in the breach than in the observance.

[5] The volume of funds which can be efficiently used depends, importantly, on the efficiency of the recipient government. Doubts about this efficiency are probably responsible for the current emphasis on private capital flows.

[6] This fact is best established and is most sophisticated in the competition to attract inward FDI (Guisinger and others., 1985).

Table 1. Net long-term resource flows to developing countries, 1990–1997($ billion)

	1990	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998**
Net long-term resource flows	100.8	123.1	152.3	220.2	223.6	254.9	308.1	338.1	275.0
Official flows	56.9	62.6	54.0	53.3	45.5	53.4	32.2	39.1	47.9
Private flows	43.9	60.5	98.3	167.0	178.1	201.5	275.4	299.0	227.1
From international capital markets	19.4	26.2	52.2	100.0	89.6	96.1	149.5	135.5	72.1
Private debt flows	15.7	18.6	38.1	49.0	54.4	60.0	100.3	105.3	58.0
Commercial banks	3.2	4.8	16.1	3.3	13.9	32.4	43.7	60.1	25.1
Bonds	1.2	10.8	11.1	37.0	36.7	26.6	53.5	42.6	30.2
Others	11.4	3.0	10.7	8.6	3.7	1.0	3.0	2.6	2.7
Portfolio equity flows	3.7	7.6	14.1	51.0	35.2	36.1	49.2	30.2	14.1
Foreign direct investment	24.5	34.4	46.1	67.0	88.5	105.4	126.4	163.4	155.0

Source: Calculated from World Bank, *Global Development Finance*, 1999.
* 1998 levels are estimated.

Table 2. The distribution of foreign direct investment flows to developing countries, 1990–1997 ($ billion)

	1990	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*
Foreign direct investment to all developing countries	24.5	34.4	46.1	67.0	88.5	105.4	126.4	163.4
Direct investment in the top 12 developing countries	17.3	23.2	33.5	49.8	68.5	76.1	94.3	114.0
Direct investment in all other developing countries	7.2	11.2	12.6	17.2	20.0	29.3	32.1	49.4
Sub-Saharan Africa	0.8	1.6	1.6	1.9	3.3	3.5	4.3	5.2

Source: Calculated from World Bank, *World Development Indicators 1999*.

ODA is probably the most valuable because it carries no corresponding liability, but the shortfall of ODA for countries seeking sustainable development is well recognized and the authors see little evidence in the United States, at least, of any quick turnaround in attitude. Direct investment, with its concomitant transfers of proprietary technology, environmental management techniques, human capital and possible access to foreign markets for value added in the host country, is very valuable (Fry, 1996). The per unit value of inward portfolio investment depends upon the degree to which the foreign savings is locked into the recipient nation and upon the efficiency with which it is allocated to projects with a high expected rate of return.

Data on recent flows of all categories of capital (foreign savings) to developing countries are given in table 1. This paper focuses on three kinds of private capital flows: direct investment, traditional portfolio debt flows and portfolio equity flows. Two categories, direct and portfolio equity, are central to this paper because they are effectively denominated in the currency of the recipient country and have different characteristics from debt flows, which are usually defined in hard currency. What is of significance here is the division of flows (of each kind) between the top twelve recipients and the rest of the developing world. Details of the division in all three kinds are given in tables 2, 3 and 4.

Private portfolio flows have surged, particularly in

Table 3. The distribution of private debt flows to developing countries 1990–1997 ($ billion)

	1990	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*
Private debt - all	15.7	18.6	38.1	49.0	54.4	60.0	100.3	105.3
Private debt in the top 12 countries	9.6	16.3	23.6	31.5	49.9	49.4	86.7	75.6
Private debt - all others	6.1	2.3	14.5	17.5	4.5	10.6	13.6	29.7

Source: Calculated from World Bank (1999). *World Development Indicators 1999.*

Table 4. The distribution of modern foreign portfolio investment flows to developing countries, 1990-1997 ($ billion)

	1990	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*
MFPI, all countries	3.7	7.5	14.1	51.0	35.2	36.1	49.2	30.2
MFPI, top 12 countries	2.5	6.7	12.9	47.7	25.3	24.8	29.4	18.7
MFPI, all others	1.2	0.8	1.2	3.3	9.9	11.3	19.8	11.5

Source: Calculated from World Bank (1999). *World Development Indicators 1999.*

countries located in regions where sustained development seemed and seems feasible. The success of countries in East Asia, prior to 1997, and Latin America is identified in tables 5 and 6. Some East Asian developing countries are beginning to attract more inward investment as they have successfully begun to overcome the disruption caused by the 1997 crisis. However, the contribution of foreign investment to sustainable development depends upon the growth of the stock of the inward investment: hence the importance of the ability to retain inflows from past years. Direct and modern portfolio investments have very different degrees of reliability (sensitivity to a lack of confidence in the host economy) and, therefore, provide different levels of benefit per dollar of investment: this is largely due to the different characteristics of the assets.[7]

The benefits (and the potential costs) of inward FDI are well known and are discussed in detail in Jun and Brewer (1997). Here we are concerned with the lack of volatility and the steady growth of the stock of inward FDI. While the physical assets acquired as a result of FDI are defined in the currency of the recipient country, the real assets will not be vulnerable to a depreciation or devaluation of the host country currency brought on by an excessive rate of inflation (a traditional macroeconomic problem) and financial assets of affiliates can be protected against weakness in the host currency by borrowing locally. When there is an overvaluation of the host currency brought about by excessive inflation, the terms of trade facing host-country enterprises improve without fundamental reason. Thus, a depreciation merely restores the original terms of trade or there will be, at most, a relatively minor weakening of the currency's real rate of exchange (the nominal rate adjusted for different degrees of inflation). The capitalized value of the affiliate's physical assets in the parent company's home currency and the price-competitiveness of exports from the affiliate will not be seriously affected in the long run (Gray and Miranti, 1990).[8]

While a host country's policy framework may explicitly attract or deter inflows of FDI in a macroeconomic sense, the detrimental effects of inadequate institutional infrastructure can be offset through the

[7] Data on FDI flows include changes in the outstanding portfolio of assets and liabilities of established MNC affiliates.

[8] This does not mean that the local affiliates benefit from the excessive inflation: indeed, they may temporarily lose their price competitiveness and find the host-country market depressed as the authorities seek to fight the inflation without depreciation. Further, a change in the real rate of exchange (terms of trade) that will engender a given current balance will, self-evidently, affect the value of the FDI asset in the home-country currency.

Table 5. Equity funds in emerging equity markets[a]

Country		Total Assets ($ million)	Number of	Funds	GDP($ billion)
Argentina		230		6	297.5
Brazil		1,497		53	759.2
Chile		1,200		7	67.1
China		6,680		108	835.7
Colombia		40		2	73.1
India		3,450		60	311.4
Indonesia		597		27	233.5
Korea		5,150		94	461.8
Malaysia		875		20	
Mexico		1,348		12	330.0
Philippines		654		13	82.9
Taiwan, Province of China		3,953		29	272.0
Thailand		2,855		31	183.2
Regions	Asia	40,125[b]		375	–
	Latin America	9,750[b]		155	–

Sources: UNCTAD (1997, Table A.19)
Note: The number of funds includes funds from the more developed countries as well as from the industrialized countries.
[a] asset values and the number of funds are taken as of September 30, 1996.
[b] assets do not include the asset values of the country funds.

creation of special enclaves which contain adequate (or, at least, less inadequate) institutional infrastructure, such as export zones, by the host country. These measures may not be needed by the more affluent developing nations in their attempts to attract inward FDI but they offer a means for poorer nations to buffer any inward FDI from domestic malfunction.[9]

When branches or affiliates of foreign banks are present in the enclave, they can shelter multinationals' foreign affiliates from any adverse effects of inadequate financial infrastructure. He (1999) shows the importance of the presence of foreign banks. When foreign banks were allowed to establish themselves in the Shanghai region of China, their presence brought about spectacular increases in inward (non-financial) FDI and in gross regional product. Inadequate institutional infrastructure can affect the benefit to be derived by a foreign affiliate in a developing country because of differences in the ability of affiliates in developing economies to engage in activities which rely on sophisticated practices. One such possibility is the difficulty which obtains in assessing the likelihood that certain transferred technologies could precipitate a disaster because of inadequate supervision by the host government.[10] Per contra, Lundan (1996) shows that inward FDI in pollution-intensive industries can improve the pollution standards of the host country because the multinational corporation is limited in its pollution capability by the demands of its customers or because the firm finds the world-wide standardization of equipment to be beneficial.

Inward FDI may be expected to grow steadily as reinvested profits expand existing affiliates and as growth in the host economy increases the capability

[9] Enclaves are often made still more attractive by the offer of various investment incentives (Guisinger and others, 1985). Of course, the creation of enclaves only makes inward FDI more attractive and the local resources must be attractive enough to foreign multinational corporations to warrant inward FDI. This requires, at a minimum, a reliable well-trained workforce which, in turn, requires good educational infrastructure.

[10] There exist modern technologies which are disaster-capable, meaning that a malfunction can cause great harm outside the confines of the property of the producer ("disasters" are distinguished from "accidents" which take place within the confines of the producer's property). When the operation is deprived of adequate supervision by the parent multinational corporation and of adequate regulation by the host country, the result could be a disaster. The disaster in the Union Carbide (India) Ltd., pesticide plant in Bhopal causing over 1,750 people to be killed by poison gas is perhaps the best example (Gladwin and Walter, 1985). On the subject of sales of baby formula in developing countries with unsanitary water supply, see Beauchamp (1983).

Table 6. Private capital flows and private equity flows into I-D countries ($ billion)

Country	*1986*	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*
Argentina									
NPCF	0.9	-0.2	2.9	5.6	13.6	10.1	9.7	16.1	19.8
PI(eq)	nil	0.0	0.4	0.4	5.5	1.2	0.2	0.9	2.2
Brazil									
NPCF	-0.1	0.5	3.6	9.7	16.2	12.3	20.0	29.7	43.4
PI(eq)	nil	nil	0.8	1.7	5.5	5.1	4.4	4.0	3.8
Chile									
NPCF	-.5	2.1	1.5	1.8	2.4	5.1	5.5	7.4	9.6
PI(eq)	nil	0.3	0.0	0.3	0.4	0.9	0.3	0.1	0.5
Colombia									
NPCF	1.6	0.3	0.2	0.7	2.1	4.3	4.7	7.7	10.2
PI(eq)	nil	nil	nil	nil	0.2	0.3	0.1	0.3	0.1
Indonesia									
NPCF	0.8	3.2	3.4	4.6	1.1	7.7	11.5	16.2	10.9
PI(eq)	nil	0.3	0.0	0.1	2.5	3.7	4.9	3.1	0.3
Malaysia									
NPCF	0.8	1.8	4.2	6.1	11.3	8.5	10.1	12.8	9.3
PI(eq)	nil	0.3	0.0	0.4	3.7	1.3	2.3	4.4	-0.5
Mexico									
NPCF	0.6	8.3	12.0	9.2	21.2	20.7	16.0	25.2	20.5
PI(eq)	nil	0.6	4.4	5.4	14.3	4.5	0.5	3.9	2.1
Philippines									
NPCF	0.4	0.6	0.4	-0.7	3.3	3.9	4.3	5.0	4.2
PI(eq)	nil	nil	nil	0.3	1.4	1.4	2.0	1.3	0.1
Thailand									
NPCF	-0.2	4.4	5.0	4.3	7.5	4.4	10.0	13.6	3.4
PI(eq)	0.0	0.4	0.0	0.0	3.1	-0.5	2.2	1.6	-0.3

Notes: NPCF = net private capital flows; PI(eq) = portfolio investment in equity markets (annual flow).
Source: World Bank (1999c). *World Development Indicators* (Washington, D.C.: World Bank)
The data set did not provide data for either Korea or Singapore.

of accommodating higher levels of technology thereby inducing the creation of new affiliates. The realized benefits of FDI also should provide confirmation that a policy framework supportive of FDI consistent with the goals of sustainable development complements well the return-seeking motives of FDI. Still, the type of FDI flowing into a country is not always under the control of the country; it simply may not possess assets and/or resources that can be exploited in an economical way without some sort of incentive housed within the policy framework. It is therefore crucial for sustainable development that incentives geared to attract FDI are consistent with the environmental concerns and objectives of the Rio Summit.

Inward debt investments constitute "traditional portfolio investment" and are ordinarily denominated in hard currency (that is, not the borrower's currency).[11] Such loans made to governments and or private entities in a developing country usually have long maturities and are endangered only by serious economic problems in the debtor country. A serious recession or a crisis can affect the ability of the debtor to service the debt or even result in default.[12] The long (original) maturities of these loans means that they can be traded in secondary markets in periods of

[11] However, see the account of the Thai crisis below.

[12] The existence and transparency of bankruptcy law is a component of the institutional infrastructure.

stress but that they cannot bring about a capital flight unless local firms (including the debtor) buy them back and, improbably, use hard currency to effect the purchase. Of course, reliance on debt investment is vulnerable to the drying up of supply in the event of bad performance by the debtor's economy and/or an increase in the risk premium when lending ultimately resumes.

Modern foreign portfolio investments (MFPI) usually comprise acquisitions of equities in (emerging) stock markets in developing countries: there are also some investments in debt instruments denominated in local currency and traded locally. The assets are, therefore, denominated in the currency of the host country and, unless closely tied to exports, are sensitive to economic conditions in the host country. The existence of an equity market of adequate efficiency in a developing country usually indicates that the country perceives itself to have achieved sustainable growth. Thus, poor countries are unlikely to be able to attract noteworthy inflows of MFPI.

In recent years investments in equity markets in I-D countries by asset-holders based in industrialized countries have increased substantially (tables 5 and 6). The most important way in which this flow of funds occurs is through the creation of mutual funds (unit trusts) in industrialized countries which specialize either in equities in one country or in a region. These funds are able to reduce transaction costs for investors, provide country-specific knowledge and proselytize investors on the virtues of international portfolio diversification as a sales promotion technique (notwithstanding caveats in the prospectus). Mutual funds can also give ultimate beneficiary owners of equities the impression, not always warranted, that by having a country specialist provide local day-to-day control over their assets their capital will be reasonably secure against sudden financial crises.[13]

As of September 1996 there existed 375 equity mutual funds specializing in Asian markets with asset values in excess of $40 billion (table 5). There also existed 31 funds which specialized in Thai securities with assets of $2.8 billion. While this was small in relation to international claims by foreign banks of about $70 billion, it was important because of its ease of encashment and lack of any fixed maturity (table 6). Equity investments are inevitably denominated in the capital importer's currency. Equities have no predetermined maturity and are traditionally regarded as long-term liabilities. However, in a liberalized system of markets and from a narrow international flow-of-funds aspect, the foreign-owned equities are easily-encashable assets (though not, in a technical sense, liquid). They can be sold at the going market price in an established market quite quickly and promptly converted to the creditor's home currency in the foreign exchange market (subject to any dislocations which exist in a crisis situation and subject to the existence of capital controls). To the extent that the capital importing countries use these inflows to finance investment in long-term projects, the capital-importing country is financing long-term investments with easily encashable liabilities and is contravening good financial practice of matching the maturities of asset and liability. Only if the financial system is robust enough so that equity flows are not volatile or the central bank has sufficient reserves of foreign exchange or lines of hard-currency credit to negate any lack of confidence, could financing investment with easily encashable funds be an appropriate policy.

The existence of foreign-owned equities in an internationally-liberalized system drastically increases the host country's optimum volume of foreign-exchange reserves. This quantum has traditionally been defined in terms of necessary imports (a flow) but should now allow for the inclusion of encashable liabilities to foreigners (a stock). This represents a fundamental change in concept and sharply reduces the benefits of the MFPI. Note too that the benefits derived from the inflow of foreign saving into a local equity or stock market depends upon the efficiency of that market as an allocative device (Singh, 1992) as well as upon the additional volume of new issues of equity by locally-owned firms attributable to the reduced cost of equity capital.

Competition among mutual funds in the industrialized world has forced some firms to seek out new areas for investment. Helliar and others (1998) report on the criteria by which emerging equity markets are opened up for investment by British mutual funds. Clearly, foreign fund managers will seek to escape from the effects of a local crisis as best they can. The result of the infusion of foreign funds into local equity markets is a substantial overhang of potentially volatile foreign exchange. A crisis, whether originating in the domestic economy or in the foreign exchange market, is likely to generate a sudden outflow of funds and to expand a domestic political or economic crisis into a foreign-exchange crisis.[14] In principle, a country with a sophisticated macro-financial policy could instruct its monetary authority to hedge the value of foreign-owned equities, but this

[13] Certainly, an individual could never hope to manage effectively a portfolio of assets in a series of apparently unrelated volatile markets.

[14] Note that traditional portfolio investment has the lender's asset specified in the lender's (hard) currency so that it is the possibility of inability to service the debt — not the foreign exchange rate — that is crucial in traditional portfolio investment.

seems to call for almost as much financial sophistication as liberalization and will substantially raise the cost of the funds.

According to Singh (1992), the purpose of the original plan for emerging nations to develop stock markets was to attract portfolio investment which would replace debt as a source of hard currencies given that commercial banks in industrialized countries were likely to be unwilling to make loans or buy bonds in emerging markets. This original plan (put forward by the World Institute of Development Economics Research in 1990) argued for the abandonment of control over international capital movements[15] and seems to show a sublime faith in the idea that equity investments in countries which cannot sell debt to foreign banks are long-term and not subject to sudden withdrawals.

PORTFOLIO EQUITY INVESTMENT

Classical economic theory sees net international capital inflows as a source of saving which can be used for capital formation and, at the same time, constitute assets that can be used by investors as a means of achieving a diversified portfolio with a high risk-adjusted rate of return. This interpretation and the argument that the freedom of international capital movements will increase global allocative efficiency both rely on the assumption that economic systems are inherently stable with no important exogenous (or endogenous) shocks to engender a financial crisis. The emerging equity markets must be assumed to have significant depth, breadth and resiliency. Indeed, in the absence of some assurance of the possibility of repatriation of funds in a time of stress, the volume of private portfolio equity investment in developing countries would remain quite small.

A financial system consists of a series of interlinked financial markets which function under known sets of regulations and procedures (including the existence or non-existence of a lender of last resort and of insurance against the failure of deposit intermediaries). The greater the number of financial products traded and the greater the inter-temporal and geographic range of those products, the more sophisticated is the system and the greater is its ability to promote allocative efficiency under tranquil conditions. A well-functioning financial system will be regulated by the financial authorities (in a national system, the central bank) and the set of policies in force and effectively administered (macro-financial policy). Given the existing set of statutes, macro-financial policy is designed to generate a combination of products, practices and regulations which will promote an effective mix of allocative and stability efficiencies.[16]

Such policies are enhanced by central bank cooperation (lines of credit) and by the creation of supranational bodies (for example, the IMF), which are designed to provide temporary assistance. Policymakers must recognize the need for transparency of regulations and practices and for the availability of reliable information so that people who are engaged in any part of the system may have a full appreciation of the way in which the system is designed to work and works (or have reliable access to someone who has such knowledge).[17] People for whom an understanding of the system is necessary include executives of both financial and non-financial corporations – especially executives engaged in international financial transactions – and people employed in the regulation and administration of the system. All of these people need to be aware of the potential for the foreign sector to generate adverse shocks.

The industrialized countries of the world have developed their financial sectors over the last century and a half (and more) and possess a series of highly specialized firms and operatives who are both well-trained and well-equipped to cope with slow change: these specialist firms create linkages among major financial markets across space and time and provide information. Within the industrialized countries, a relatively fast rate of innovation resulting from the liberalization of capital markets, the adoption of new and different exchange-rate systems, the introduction of computers and the ability to quickly transact financial operations throughout the integrated sector has been accomplished with relatively little stress (although the crises of the pound sterling and the Italian lire in 1992 could be attributed in part to a failure of national central banks and/or treasuries to understand the degree to which new financial instruments, such as derivatives, could be profitably used by private firms to punish badly overextended, vul-

[15] This required the elimination of section 3 of Article VI of the International Monetary Fund's Articles of Agreement. The question of the absence of capital controls is considered in Section IV below.

[16] Macro-financial policy can be seen as the financial equivalent of macro-organizational policy (Dunning, 1992) which is designed to make the country attractive to internationally-mobile productive activities. This paper does not address "monetary policy" designed to reduce the variability of GDP around its trend.

[17] People who are active in only one aspect of the system, for example, depositors in a financial intermediary, need have a knowledge only of the institutions which they use and any related institutions.

nerable national currencies).[18] Even given that advanced capitalist economies are likely to have efficient financial infrastructures does not mean that mistakes cannot happen and that crisis is impossible. In addition to the foreign-exchange crises of sterling and the lire, the near failure of Long-Term Capital Management in the United States in 1998 was only resolved by astute and massive rescue operations.[19] That these experiences did not result in major instability offers proof of a good measure of stability efficiency in the financial system of the industrialized countries.

Generally, the financial sectors of the industrialized countries have avoided severe crises despite the development of domestic and international strains as new regulatory frameworks, new technologies (including new financial instruments) forced new awareness of different dimensions of risk and as portfolio managers and other actors push their analytic models to the limit. Advanced capitalist economies can then be expected to have efficient financial infrastructures, provided that the rate of technological change does not exceed the capacity of actors to keep up-to-date with the intricacies of innovations and provided that prolonged tranquillity does not introduce underestimation of the probability of adverse shocks in the mindset of operators in the market.[20] One consequence of the generally adequate financial infrastructure in industrialized countries is that models of the financial sector in, and transactions among, these countries had substantial resistance to shocks and models of international transactions did not need to specify explicitly the components of financial infrastructure. Unfortunately, most pre-1997 analyses neglected to consider the question of the adequacy of financial infrastructure in developing countries.[21]

An efficient financial infrastructure implies the existence of a financial policy framework that provides for adequate prudential regulation. The latter is a static concept and, as Herring and Litan (1994) and Maehara (1994) suggest, the goal of having prudential regulation keep up with technological innovations in times of rapid change may not, even in sophisticated systems, be feasible. This point overlaps with the idea that as technology advances, problems of enforcement grow and regulation will distort capital markets without an adequate increase in stability-efficiency. This is a strong argument for greater reliance on market forces (i.e. for liberalization) as a means of disciplining firms exposed to excessive risk.[22]

Good financial infrastructure requires: good macro-financial policy and the power to introduce the needed constraints and support systems vested in the central bank; the acceptance by the financial community of the authority of the central bank; good data so that the central bank and operators in financial markets are able to make rational decisions on a reliable basis; and ongoing research into the operations of the system. The greater the number of specialist institutions linking together markets for different kinds of assets and liabilities, the quicker the speed of reaction of these institutions to new information, the more reliable the information, the higher the levels of operator experience and skill in acting in the existing system of financial markets and the greater the mass of financial resources at the disposal of stabilizing institutions, the greater is the adequacy of financial infrastructure of the country. However, there is an internal problem here: the ability to generate good financial infrastructure depends upon the existence of good financial infrastructure. Macro-financial policy must be able to rely on the existence of good data and responsive financial firms if it is to be able to generate good macro-financial policy. Currently, the Chairman of the Board of Governors of the Federal Reserve System is regarded by the financial sector of the United States as a central banker par excellence. He would not be as successful were he to be the cen-

[18] For a discussion of the contribution of computer links to the growth of international financial flows, see Minsky (1986). For an assessment of central bank policy in Italy in 1992, see Salvatore (1998).

[19] The bail-out of Long-Term Capital Management in August, 1998, in New York required an infusion of $3.5 billion.

[20] The latter is the essence of Minsky's (1986) theorem, which can be seen as a variant version of "adaptive expectations". The theorem identifies a subtle but potentially serious reduction in the quality of the financial infrastructure as operators are lulled into a sense of false security by a prolonged absence of adverse shocks or by the creation of unidentified speculative bubbles, possibly caused by general or sectoral "irrational exuberance" (Canterbery, 1999).

[21] The crisis in East Asia in 1997 served as a catalyst for analysis of "why things went wrong". In general, analysts have focused on what may generally be termed "inadequacies of capital markets" rather than on the broader range of characteristics of I-D and poor countries contained within the rubric of "institutional infrastructure" as the idea is developed here. Eichengreen and others (1998) have conducted the most broad-based assessment of which the authors are aware.

[22] Herring and Litan (1994) and Maehara (1994) both advocate allowing individual firms/banks to fail in the expectation that this will not generate a crisis and should cause others firms/banks to reduce their vulnerability and to enhance the stability efficiency of the system. In a system with good stability-efficiency, this is very likely to be so, but the stakes are high and, in many cases, the odds are not knowable. The proposal can be seen as compatible with ensuring that Minsky's (1986) fears of operatives being lulled into a sense of false and overoptimistic security will not occur, but it neglects the possibility that one failure can, in a taut system, start a chain reaction.

tral banker in a country in which good financial infrastructure did not exist.

The lack of an adequate financial infrastructure implies three things.[23] First, the transaction costs of using the system of financial markets will be higher, the greater the degree of inadequacy of the infrastructure. Second, the allocative efficiency of the system will be reduced as individual investors make suboptimal decisions as a result of their lack of understanding of the fine points of the system, from the inferior quality of information available, or from misguided attempts to steer funds to "cronies". Third, the probability of a major crisis is greater than would exist with adequate infrastructure because economic units will not correctly assess uncertainty and the danger of a vicious cycle. The last possibility is significantly enhanced in an open economy allowing transactions on both goods-and-services and capital accounts: it is this possibility of substantial instability that tends to be neglected in traditional analysis.

A system of markets, linkages and skilled operators (good financial infrastructure) is not created overnight and is likely to be very sensitive to culture, tradition, established practices as well as to the set of "formal institutions" inherited from the past. An I-D country may very well have a financial sector which operates with more-or-less satisfactory effectiveness in allocating capital in a closed economy and/or in an environment which is evolving only slowly and the country may have financial infrastructure which enables it to withstand some domestic shocks without creating a financial crisis.[24] Unsatisfactory financial infrastructure is likely to build up stresses over time so that the adequacy of a country's financial infrastructure is likely to deteriorate in the absence of a pause in economic growth and/or advances in financial technologies.[25] Given that institutions and expertise (infrastructure) require time to develop, a system that has been inherited from the past can tolerate only some (unknowable) rate of innovation of financial markets and practices without potentially drastic loss of effectiveness. The critical rate of innovation may easily be exceeded in a developing economy either when the economy has experienced rapid growth over a period of years — and expectations have adapted to assume the inevitable continuation of that growth (Tversky and Kahneman, 1982) — and/or has, in the process, become deeply exposed to the substantially more sophisticated global financial system developed by the industrialized economies with all of the possibility of exogenous shock which "membership" in the global system creates. All of the indigenous participants in a national financial system cannot be expected to have a full appreciation of the benefits and the potential costs of the new internationally-open system. Under these circumstances, there will be a gap between the quality of financial infrastructure in existence and the quality required if stability efficiency is to be adequate in the new more open and sophisticated financial system. It is this gap between the existing and the required quality of financial infrastructure which can be held largely responsible for the crises in Thailand and, through contagion, in other East Asian economies.[26] From a policy framework perspective, then, it is important that adequate regulations and procedures are created to support the function of a solid financial infrastructure: this is an example of (financial) institution building.[27]

In Thailand, financial infrastructure fell short of what was required in virtually every dimension: exchange-rate policy; the sophistication of private financial institutions, recognition of the need to hedge foreign-exchange exposures; culture; the accuracy of firms' financial statements; the effectiveness of prudential regulation; and the vulnerability to a panic withdrawal of non-residents investments in equities.[28] No single dimension was crucial in bringing about the ultimate flight from the baht and the abandonment of the dollar peg on July 2, 1997: all contrib-

[23] Qualifications to the efficiency of the market system usually emphasize the first aspect of greater transaction costs but neglect the second which derives from imperfect, and possibly asymmetric, information. Asymmetric information receives great stress in Eichengreen and others (1998) and the possibility of (deliberately) bad data relatively little analysis. In financial systems in developing countries, the second issue is of major importance because it contributes to the potential for instability (Rahman, 1998).

[24] One of the major benefits from the establishment of branches and affiliates of major global banks in an industrializing country is the introduction of better banking techniques which multinational banks bring with them. These techniques may spill over to indigenous banks if competition between the two groups is allowed.

[25] There is a similarity here to Minsky's theorem: small shocks will allow the financial infrastructure to be improved at some cost of short-run and localized dislocation (cf. Maehara, 1994).

[26] The problem of contagion is not addressed in this paper. Contagion has clearly been a problem in the East Asian crisis but it operates largely through the mindsets of foreign asset holders who, having misread the effectiveness of financial infrastructure in the country in crisis, take steps to reduce their positions in countries with similarly inadequate financial infrastructure and which are suddenly perceived to be potentially subject to similar adverse shocks. For analyses of the East Asian financial crises, see Letiche (1998) and Rahman (1998).

[27] For a definition of "institutions" see World Bank (1999, 22-23).

[28] What happened in Thailand was an exemplar for Indonesia, Korea, Malaysia and the Philippines except that these countries (with the exception of Korea) were shocked by contagion rather than by the original loss of confidence in a national currency.

uted, directly or indirectly, to the crisis. The individual strands of inadequacy can be examined sequentially.

In any crisis which finds its roots in the international sector, foreign-exchange policy needs to be examined first. In an attempt to attract foreign capital and to limit domestic inflation, the Thai government had, with the encouragement of the International Monetary Fund, tied the baht to the United States dollar so that its rate of exchange was fixed. Note that this policy optimistically assumed that the Thai economy had the stability efficiency to withstand any adverse shock that the U.S. economy could withstand. In practice, this proved to be untrue. At a time when the dollar strengthened against other major currencies in 1997, some relative inflation in Thailand caused the baht to strengthen in real terms against the currencies of its competitors on two counts. The net result was that the price-competitiveness of Thai exports was eroded.

In consequence, the central bank needed, if the pegged rate was to be sustained, to raise the yield on loans denominated in baht to finance the reductions in the rate of growth of exports. Banks and non-financial firms which had access to dollar or yen loans were able to borrow in these currencies at substantially lower rates and, in this way, to reduce apparent borrowing costs. Clearly, more sophisticated bankers and executives of non-financial firms would have recognized an interest rate premium to be a sign of potential weakness and would have borrowed in hard currency only if they could have saved a sum large enough to allow for an exchange rate-hedge and would have hedged their positions. It seems that both non-financial firms and banks which borrowed in hard currency to finance activities which yielded baht were naively relying on the continuation of the dollar/baht rate of exchange.[29] Once the peg to the dollar was seen to be in danger of collapse, the baht was subjected to serious withdrawals of foreign capital.

In Thailand, as elsewhere in East Asia, culture made transparent disclosure of financial conditions much more difficult to achieve with the net result that balance-sheet data hid the very highly-leveraged positions of many large firms (as well as the foreign exchange exposure of banks and some large non-financial firms). One way in which the vulnerability was hidden, in addition to lax accounting standards, was through substantial reliance on related-party transactions and through off-balance sheet financing of debt. These conditions made it possible for bankers and executives of non-financial firms to take undue risks without these risks being fully appreciated by foreign lenders and investors.[30] One study (Rahman, 1998) emphasizes the inadequacy of the auditing process in Southeast Asia – particularly by international firms. The study reports "horror stories" of firms given a clean bill of health by an international accounting firm only to fail weeks later. Of course, the local managers of country or regional unit trusts/mutual funds should have been aware of the inadequacies of the auditing process in a region in which they were, ostensibly at least, specialists.

The level of prudential regulation of the financial sector was simply inadequate (as the lax accounting reporting suggests). In part, this was due to a traditional antipathy for disclosure on the part of the Thai banks.[31] Both the general disregard for accurate data and the suspicion of authority made the task of imposing adequate standards of prudential regulation more difficult as did the lack of apparent need for concern with malfunction.[32]

One major weakness of central bank policy was the fact that it used up by far the greater part of its foreign exchange reserves in trying to maintain the peg (in accordance with the IMF policy). When renunciation of the dollar peg proved inevitable, there were no reserves left to support the baht against the swings of speculation which occurred.[33] In consequence, the damage inflicted on Thai firms burdened with debt denominated in foreign exchange was unnecessarily great. The social cost of the crisis was

[29] This was not as naive as it may appear *ex post facto*. Rahman (1998) notes that rating agencies in New York did not reduce their ratings on sovereign debt of the five East Asian countries until well after the start of the crisis.

[30] This lack of familiarity of East Asian practice indicates a substantial weakness in the financial infrastructure of industrialized countries: financial firms were prepared to lend money and to acquire equities without a thorough understanding of the lack of reliability of their data. Clearly, the investment was not sufficient to precipitate a system-wide crisis in the larger and more robust global system.

[31] The Thai banking system contains a large number of banks owned by overseas Chinese who have a very strong antipathy for disclosure and which tend to operate within a network of overseas Chinese firms in the region (Australian Department of Foreign Affairs and Trade, 1995).

[32] Eichengreen and others (1998, 21-22) puts great emphasis on the contribution of the inadequacy of prudential regulation to crisis (to the point that the expression, "inadequacy of prudential regulation" is used six times in one paragraph). The study correctly points out that liberalization magnifies any inadequacy in the network of prudential regulation. Of course, opening the financial system up to a more sophisticated system will magnify the shortcomings substantially more.

[33] This point was made by Peter B. Kenen at the twenty-fifth Annual Conference of the Eastern Economic Association, March 12, 1999, at Boston, Mass.

Table 7. Variables Used in Studies of Determinants of Direct or Portfolio Investment

Grosse	*Singh and Jun*	*UNCTAD*
Market Growth	Market Size	Market Size
Exports/Imports	Market Growth	Change in Market Size
Interest Rates	Exports	Exchange Rates
Credit	Wage Rates	Exchange Rate Variance
Inflation	Taxes	
Fiscal Balance	Work Days Lost	
Foreign Exchange Reserves	Political Risk	
GDP per Capita	Operating Risk	
Price of Oil	Debt Management	
	Home Country Factors	
Mody and Srinivasan	*Taylor and Sarno*	*Dilyard*
Market Size	Credit Rating	Market Size
Cost of Investment	Exchange Rates	Debt Burden
Taxes	US T-Bill Rates	Interest Rate Differences
Labor Costs	US T-Bond Rates	Credit Rating
Propensity for Trade	Real US Industrial Production	Stock of direct investment
Stock of direct investment		Profitability of direct investment
Country Risk		Size of Stock Market
Infrastructure		

substantial in the region.[34] The crisis was reinforced when domestic banks became insolvent when the prices of real assets fell drastically and firms declared bankruptcy.

THE DIVISION OF PRIVATE FLOWS BETWEEN INDUSTRIALIZING/DEVELOPING AND POOR COUNTRIES

It is useful to summarize the argument to this point: both I-D and poor countries need inflows of private foreign investment to achieve sustained development.

Inward FDI requires a certain degree of institutional infrastructure (both financial and legal) which is likely to be available in the higher-income I-D countries but which must be steadily improved through time as MNCs develop higher levels of expectation about the needed level of sophistication in the institutional infrastructure.[35] Poor countries can only hope to achieve inward FDI if they have specific assets which attract MNCs in industries which rely heavily on available assets (Dunning and Narula, 1996).[36] For this they will require a high level of institutional infrastructure which is likely to be most effectively supplied in an enclave. Poor countries are also likely to need to have the capability of negotiating with MNCs and of formulating an inward-investment policy framework (with a full knowledge of the potential costs of such a plan). While the resources needed to attract inward FDI probably have high opportunity cost, the direct benefits and positive externalities should also be high.

[34] In addition to the usual indicators of cost, there is a real possibility that the Thai economy suffered as Thai-owned firms were so weakened by the crisis as to be acquired relatively cheaply by foreign MNCs. As yet there are no data on this phenomenon and it presents scope for a very interesting inquiry.

[35] The Commission of Sustainable Development highlights the important role of government in institution building for financial sector development.

[36] Dunning and Narula (1996, 1-3) identify the deficiency in "location-bound created assets" as a cause of the low rate of inward FDI in poor countries. This concept comes close to the idea of institutional infrastructure since the assets have to be created by the local (host) economy and cannot be supplied by the MNC except in a defined enclave in which event the foreign affiliate is effectively cordoned off from the host economy.

Table 8. Concentration of foreign direct investment in a select group of countries, 1990-1997 (per cent)

	1990	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*
Share held by top 12	70.5	67.3	72.6	74.3	77.4	72.2	74.6	69.8
Share held by top 8	62.9	61.0	68.6	69.1	69.3	65.0	66.4	62.4
Share of top 12 held by top 8	89.2	90.6	94.6	93.1	89.6	90.1	89.0	89.4

Source: Calculated from World Bank, World Development Indicators, 1999.

Table 9. Concentration of private debt flows in a select grouping of countries 1990-1997 (percent)

	1990	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*
Share held by top 12	*61.1*	*87.6*	*62.1*	*64.3*	*91.7*	*82.4*	*86.4*	*71.8*
Share held by top 8	*62.8*	*68.6*	*56.0*	*56.4*	*58.6*	*67.4*	*65.6*	*56.3*
Share of top 12 held by top 8	*102.9*	*78.4*	*90.3*	*87.7*	*64.0*	*81.8*	*75.9*	*78.5*

Source: Calculated from World Bank, World Development Indicators, 1999.

Inward traditional portfolio investment also requires a discernible degree of institutional infrastructure but will be judged mainly on the ability of the economy to avoid financial crises. Failure to exhibit a satisfactory level of institutional infrastructure will probably result in a higher cost of borrowing for some countries rather than a complete lack of availability. While financial infrastructure is important, the other dimensions cannot be neglected.

Inward modern foreign portfolio investment must be sustained in the event of recession or financial stress lest its exodus aggravate adverse conditions and instigate a financial crisis. Poor countries will not be able to attract MFPI because of the absolute lack of financial infrastructure. Industrializing/developing countries must recognize the vital importance of good financial infrastructure and must take conscious steps to generate it.

Attracting inflows of private portfolio investment to a developing economy can be valuable as a supplement to other types of investment inflow. However, if the inflows are not retained and are dissipated by outflows, a policy of attempting to attract easily-encashable foreign capital may not be a good one (irrespective of the efficiency of the local equity market). The damage inflicted by a crisis is simply too great. The key to the retention of MFPI is strong financial infrastructure. Since one purpose of strong financial infrastructure is to deter the existence of financial stress and to preclude panic repatriation of funds in times of financial stress, there is a question as to whether completely unimpeded capital mobility is appropriate for developing countries.[37]

The major argument for complete liberalization of capital movements (that is, the complete absence of controls on international funds transfers) is the enhancement of global allocative efficiency. There is nothing wrong with this goal[38] provided that the countries have adequate financial infrastructure and most analyses now address the ability of a country to effectively create various aspects of financial infrastructure (for example, prudential regulation and good macroeconomic policies). Indeed, financial capital movements are extremely difficult to control and have become more difficult in the light of recent technological innovations. Any regime of controls runs the danger of seriously distorting capital flows so that the cure may be worse than the disease.

Such a policy must address the level of sophistication of financial infrastructure in all of its dimensions. It is perfect freedom of capital movements which allows the easy encashability of assets and the

[37] The current policy of the IMF is, on the instructions of its policy-setting committee (which comprises finance ministers and central bankers), to amend the Fund's Articles of Agreement so that the Fund can promote the orderly liberalization of capital movements (Eichengreen and Mussa, 1998, 16). Analyses of the process are now subject to more caveats than in 1997 (Fischer, 1997, 1998).

[38] Particularly with respect to direct and traditional portfolio investment.

Table 10. Concentration of portfolio equity flows in a select grouping of countries, 1990-1997 (per cent)

	1990	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*
Share held by top 12	66.7	87.7	91.4	93.5	71.8	68.7	59.8	61.9
Share held by top 8	52.7	83.2	67.5	76.1	56.9	48.6	43.4	54.9
Share of top 12 held by top 8	79.0	94.8	73.8	81.4	79.3	70.7	72.6	88.6

Source: Calculated from World Bank, World Development Indicators 1999.

Table 11. Portfolio equity and direct investment in a select group of countries, 1993–1997 ($ billion)

	1993	*1994*	*1995*	*1996*	1997
Direct investment in:					
Argentina	*3.3*	*3.1*	*4.8*	*5.1*	6.6
Chile	*1.0*	*2.6*	*3.0*	*4.7*	5.4
South Korea	*0.6*	*0.8*	*1.8*	*2.3*	2.8
Malaysia	*5.0*	*4.3*	*4.1*	*5.1*	5.1
Mexico	*4.4*	*11.0*	*9.5*	*9.2*	12.5
Thailand	*1.8*	*1.4*	*2.1*	*2.3*	3.7
Equity investment in :					
Argentina	*5.5*	*1.2*	*0.2*	*0.9*	2.2
Chile	*0.4*	*0.9*	*0.3*	*0.1*	0.5
South Korea	*6.0*	*2.5*	*3.6*	*3.7*	1.3
Malaysia	*3.7*	*1.3*	*2.3*	*4.4*	(0.5)
Mexico	*14.3*	*4.5*	*0.5*	*3.9*	2.1
Thailand	*3.1*	*(0.5)*	*2.2*	*1.6*	(0.3)

Source: Calculated from World Bank (1999). *World Development Indicators* (Washington, D.C., World Bank).

concomitant conversion of local funds into hard currency.

A financial system in which data are not reliable and operators are ignorant of the implications of membership in a global system is in danger of having inadequate stability efficiency.[39] The benefits foreseen by advocates of complete mobility of international capital would, if adequate stability efficiency is to be maintained, require a highly sophisticated financial sector in each and every country.

Rahman (1998, 36) calls for international accounting firms to take the necessary steps so that the quality of audit services provided by their national practices all over the world does not fall short of practices

[39] The real cost of a crisis in an I-D country depends very much on the degree to which the other countries in the world are able to maintain an open market for the crisis country's exports. This requires an importer of last resort and is a role to be filled by the world's financial hegemony. The cost to the crisis country exceeds the bankruptcies of existing firms: it includes the very weakened condition of surviving firms and the high probability that the better of these firms will be acquired by foreign multinational corporations at the expense of national net worth.

in North America and Europe. This recommendation is based on the failure of firms that had received a "clean bill of health" only a few months earlier but it conjures up severe problems of extraterritoriality. Clearly Rahman is correct in the sense that common accepted standards of accounting would preclude the possibility of bad investments by lenders and mutual fund managers in the industrialized world but, like the Panglossian vision of a world with completely liberalized movements of portfolio capital, the approach neglects the adequacy of financial infrastructure (the state of preparedness of the financial sector to conform to the conditions required). Eichengreen and others (1998) offer a sensible review of the problems that must be confronted before freedom of financial capital can be as widespread as liberalized international trade now is. But the study fails to consider the cost of the inordinately larger reserves of foreign exchange which are required as well as the (opportunity) costs of the expenditure of resources in developing the necessary financial infrastructure (with its heavy demands on human capital) as a cost to be offset against the marginal benefits of freedom of international capital movements.

THE SIMILARITIES OF THE DETERMINANTS OF THE TWO INFLOWS: AN EMPIRICAL STUDY

As important as ODA is to promote economic development, it is not sufficient to sustain development. Ultimately, other sources of capital will be needed, and I-D countries are turning increasingly to the private sector to foster economic growth. The private sectors of I-D countries are, however, not sufficiently strong to generate all the private capital needed for continuing economic development. What cannot be raised internally therefore must come from external sources. External private capital flows into a developing country in two forms, direct and portfolio, with portfolio consisting of modern portfolio investment (equity) and debt.

Generally speaking, those entities that engage in direct and portfolio equity investment do so for different sets of strategic reasons. Direct investment in real assets implies the desire to control assets, while portfolio investment uses the ownership of assets to earn a definable return or gain.[40] As the ability of firms, institutions and individuals to invest in the private sectors of other countries becomes more complex in a globalized financial marketplace, however, the distinction between what functions as direct or portfolio investment can become less clear (Dunning and Dilyard, 1999). For example, it is conceivable that a firm can engage in a portfolio of several (relatively small) direct investments in several countries with the idea that those investments that do not meet previously established criteria will be divested. On the other hand, a consortia of investing entities, each making what essentially is a portfolio investment, could pool their resources to exert functional control over the firm in which the investment has been made.

Historically, studies addressing the determinants of private investment in I-D countries have treated direct and portfolio investment as distinct entities, concentrating primarily on internal country-specific (pull) factors to explain direct investment and external (push) factors to explain portfolio investment. Country-specific factors include domestic market size and/or growth, the history of exchange rate variability, and those such as interest rates, inflation, political risk and the existing stock of direct investment that address the general environment for direct investment. External factors, on the other hand, refer mostly to the interest returns available in alternative locations (developed countries) for portfolio investment; the expectation of higher rates of return on equity and bond investment in I-D countries pushes investment to those countries. Recent studies by Grosse (1997), Mody and Srinivasan (1998), Singh and Jun (1995), UNCTAD (1993), and Taylor and Sarno (1997), however, have expanded the list of explanatory variables for both types of investment to include internal and external variables. Recognizing that the functional purposes of direct and portfolio investment can be similar, Dilyard (1999) developed a common set of explanatory variables applicable to both. Table 7 presents a summary of the variables identified in all of these studies.

In his empirical study of the net flows of direct and private portfolio[41] investment to three East Asian and three Latin American countries[42] from 1980 to 1995, Dilyard used the following set of variables to explain each type of flow:

- Gross domestic product (market size);
- The ratio of total annual interest paid on all debt (domestic and foreign) to gross national product (debt burden);

[40] The operational distinction between direct and portfolio equity investment actually revolves around control, with 10 per cent ownership of a company deemed (by the UN, World Bank and others) to be sufficient to exercise managerial control.

[41] Private portfolio investment was defined as equity and all non-guaranteed debt, including bonds and bank loans.

[42] The East Asian countries were Indonesia, Malaysia and Thailand, while the Latin American countries were Argentina, Brazil and Chile.

- The ratio of short-term debt to total private debt (debt burden);
- The difference between the average annual rate on US Treasury Bonds and the average interest rate on all new private debt added during the year (interest rate differences);
- The difference between the average annual US prime lending rate and the average interest rate on all new private debt added during the year (interest rate differences);
- A comparison of the country's credit rating as determined by Institutional Investor magazine and the average credit rating for all rated countries (credit rating);
- The stock of all inward direct investment from all sources (stock of existing direct investment);
- The combined gross domestic product of developed (OECD) countries (market size);
- The stock of all outward-bound direct investment from OECD countries to I-D countries (a push factor)
- The profitability of US direct investment in an I-D host country (investment environment);
- The year-end capitalization level of the I-D country's stock market (a pull factor);
- The year-end capitalization of developed country stock markets (a pull factor).

Dilyard modelled the combined net flows of direct and portfolio investment against these variables using time series analysis techniques. Adjusting for the incidence of high degrees of correlation among variables common to this type of analysis, he found that either or both direct and portfolio investment in each of the two regions was strongly influenced by GDP, credit rating, the profitability of direct investment, and the size of the country's stock market.

These variables are pertinent to the role of private investment in sustainable development because they point to the environment in which investment can flourish. A large domestic market (GDP), a growing private sector (size of stock market), signs that the economy can support private investment (profitability), and evidence of fiscal and/or monetary infrastructure (credit rating) are all viewed positively by potential private investors. Thus, continuing inflows of private investment, in all its forms, is evidence that foreign investors view favourably the prospects of ongoing or sustained development in a country.

Applying this analysis to the concentration of direct and portfolio investment shown in tables 2, 3 and 4 suggests that only a small number of countries are expected to have sustained development. In fact, the concentration of investment flows can be shown to be even more severe by focusing on the six countries used in Dilyard's study plus China and Mexico. During the 1990s, these eight countries have been the destination of the vast majority of direct and portfolio investment.

The concentration of direct investment in these eight countries is demonstrated in table 8. On average, 90 per cent of the direct investment going to the twelve countries in tables 2, 3 and 4 and roughly two-thirds of the direct investment flowing to all I-D countries have gone to these eight countries from 1990 to 1997. This trend is mirrored in private debt. As table 9 shows, the eight countries were recipients of, on average, a little over 60 per cent of net private debt flows to all I-D countries. Debt flows, however, experienced more volatility than direct investment. Some of this volatility is due to the inclusion in debt flows of debt from private creditors that actually is guaranteed by a third party. Economically stronger countries tend to receive proportionally smaller amounts of this kind of debt than private, non-guaranteed debt. Thus, the large ($40 billion) increase in private debt going to I-D countries from 1995 to 1996 is likely made up of a significant portion of private, but guaranteed, debt.

If the distribution of direct investment and private debt suggests a strong relationship between a country's economic health and its receipt of private capital, what does the pattern of equity investment say? As is seen in table 10, the eight countries attracted anywhere from two-thirds to four-fifths of all equity investment in I-D countries from 1991 to 1993, but a lower amount from 1994 through 1997. Given the relative stability of direct and portfolio debt investment flows, one might expect the behaviour of portfolio equity investment to also be relatively stable.

Equity investment can be notoriously volatile and reacts quickly to any news that is expected to affect economic growth either positively or negatively.[43] Thus, even countries that appear to be an attractive location for direct investment may have undercurrents that frighten away portfolio equity investment. As evidence, examine the pattern of portfolio equity and direct investment in Argentina, Chile, South Korea, Malaysia, Mexico and Thailand from 1993 to 1997 (table 11). Each of these countries had at some point in that period either an economic crisis of its own or were adversely affected by the contagion of crises occurring in the region.

The response to these economic concerns in portfolio equity investment was rather immediate and dramatic capital flight. The problem was exacerbated as

[43] As evidence of this statement, one only need examine the recent turmoil in the United States stock market being caused by a combination of inflation fears, disappointing corporate earnings reports, and expectations on Federal Reserve Bank policy pronouncements.

well by its suddenness; these countries had the outward appearance of internal economic strength. Once weakness was revealed, the assumption of stability disappeared. The duration over which this capital flight occurred was (and is) a combination of the severity of the problem, investor expectations about the future and the existence of buying opportunities.[44]

Direct investment, on the other hand, did not experience the same kind of volatility as did portfolio equity investment. Indeed, in many cases direct investment actually increased. One reason this may have been occurring is that the flight of equity investment had created bargain basement buying opportunities for direct investment.[45]

It is difficult, of course, to use aggregate data to get inside the heads of those who engage in portfolio equity or direct investment, particularly with regard to their reactions to internal economic conditions. The empirical data presented here suggests that it is in portfolio equity where the most susceptibility to uncertainty occurs and where the lessons of East Asia (and more recently Eastern Europe) are most acute. As noted earlier, one of the problems that surfaced in Thailand in 1997 was the revelation of an amorphous financial infrastructure that brought about a crisis that not only severely damaged Thailand's economy but infected other country's as well. It also is instructive to note that the underlying causes of Thailand's weak financial infrastructure were largely irrelevant to the consequent capital flight; all that mattered was that which was believed to be true was proven false.

It is impossible to know how less severe capital flight would have been from these countries had the underlying economic fundamentals been shown to be more robust. Likewise, it is impossible to know how less violent the more recent reactions to similar uncertainties about the financial infrastructure of Russia would have been had the events in Thailand not occurred. The badly negative responses to unfavourable news about I-D countries' financial sectors, however, reinforce our premise that a sound financial infrastructure is a necessary component of sustainable development.

Arguably, a different set of policies, particularly those relating to financial infrastructure and prudent supervision, could have kept the crisis in East Asia from occurring. While a greater degree of disclosure of financial conditions (both at the national and firm level), rules, regulations and practices might have made those entities investing in East Asia more aware of the full nature of the financial environment in which they were participating, it may also have depressed the level of investment in the first place. This relationship between financial infrastructure and policy frameworks and the level of FDI and portfolio investment, which is revealed through empirical studies that address the determinants of those kinds of investment, thus becomes increasingly important when formulating and implementing policy.

POLICIES FOR INSTITUTION BUILDING

Both domestic and foreign private investment are responsive to the quality of institutions in a developing country. This fact requires that policymakers give active attention to the need for building institutions and that they recognize the difficulties of the task. Better institutions (World Bank, 1999b, 22-3) facilitate economic growth in much the same way that improved physical infrastructure contributes to economic growth. However, where the need for upgrading physical infrastructure in both quantity and quality is made clearly apparent (to both taxpayers and policymakers) by bottlenecks and increases in transaction costs, the need for upgrading institutional infrastructure is less obvious. Moreover, improvements in institutional infrastructure may encounter resistance because they require reversing precedent, confronting cultural values, or even worse, threaten the narrow economic interests of the members of the élite.

The need for good institutional infrastructure is not limited to the financial sector, though there is a strong case to be made that the need for good institutions in that sector is paramount.[46] Foremost among these in a world in which the superior efficiency of a system relying on free markets and private sector development are the existence of property rights (legal)

[44] Whenever a large amount of investment flows out of or into a stock market over a relatively short period of time, the possibility that investors are responding to a herd instinct in addition to (or in place of) more quantifiable factors is present. While this behaviour is not based on financial reasoning, its impact on the affected market can be profound.

[45] For example, East Asian cement manufacturers, which are faced with high over-capacity and flagging demand, have been the target of much acquisition activity.

[46] Gray (2000) identifies eight areas in which the quality of institutions ("socio-economic infrastructure") is important: legal; educational; technological; financial; communications; cultural; government administration; and the political system. "Socio-economic infrastructure" is a slightly broader concept than "institutional infrastructure": the former includes the ability and the willingness of the population to work within an existing set of institutions, as well as the set of institutions itself. That this distinction can be important in the financial sector is shown by some features of the Thai financial crisis in 1997. With reference to FDI, this distinction may be taken to include the attitudes and work ethic as well as the skills of the labour force.

and the probity and constructive commitment of those in political power (government administration).

Foreign direct investment is, by definition, private. Nations seeking to attain sustainable development must compete among themselves for a share of the flow of FDI from richer to poorer countries. To attract FDI to generate offshore production of goods and services destined for markets in OECD countries, with all of the current account benefits that this genus of MNC affiliates promotes (Fry, 1996), an efficient set of institutions that both accommodates and nurtures private sector development is essential. While the benefits of good institutional infrastructure apply to both foreign-owned and domestic firms, foreign-owned capacity is, because of its international mobility, much more locationally sensitive to the quality of institutional infrastructure.

Fortunately, inward FDI does not require that the availability of good institutional infrastructure be nation-wide. Countries in the early stages of achieving sustainable development can create enclaves (restricted geographical regions) in which both good institutional and physical infrastructure are provided.[47] Successful development in enclaves can create spillover effects and lead to wider improvements in infrastructure and, in the process, provide growth impetus to the rest of the national economy.

Traditional foreign portfolio investment also requires good institutional infrastructure. Evidence of an example of this need is the decision of the Japanese Government in November 1999 to shift the focus of its aid to Indonesia from financial ODA to the loan of financial experts.[48] The cited reasons for the change in policy are the "lack of legal know-how and the country's shattered banking system". The legal structure and the collapse of the banking system interact in that the non-existence of an operational bankruptcy law and the huge volume of bad debts in the banking system combine to render the banks incapable of transmitting financial transfers to firms in the export sector.

Modern foreign portfolio investment is probably the source of external funds (saving) that is most sensitive to the quality of institutional infrastructure. Only very high quality institutions can both attract and retain MFPI which can be so subject to herd reactions by foreign portfolio managers.

Policy formulation depends upon awareness on the part of policymakers and elected legislators of the need for high quality institutional infrastructure. The first step in promoting institution building is the provision of evidence of the importance of institutions so that policymakers recognize the building of institutions as an integral part of the search for sustainable development.[49] From recognition in general it is a short step to identification of what constitutes qualitative improvements in the various sectors. Identification of those institutions which can most usefully be improved does not mean that the process is simple: conservatism, vested interests, fear of foreign domination and cultural values and tradition can all impede institution building. The process is, then, a long one and it must be conducted with standing commitment and a long-term outlook (thus differing from physical infrastructure which usually can be identified with individual, possibly major projects). The upgrading of institutional infrastructure will require broad-based educational programs if new institutions are to be accepted by those affected.

Governments must recognize, in addition, the importance of both legislation and new, refined regulatory systems. The legal and regulatory dimensions must precede the upgrading of institutional infrastructure because there is an inevitable lag between facilitating more sophisticated practices and the ability of people working in the affected sector(s) to learn to adapt to the new system.

Finally, as the analysis of the recent financial crisis has shown, the rate of institution building required is positively related to the rate of change imposed by circumstance. In context, circumstances can be beyond the control of policymakers, as when new technologies force different procedures upon the national economy. However, a rapid rate of change can also be imposed by opening up the economy (or a sector) to a more sophisticated international system and this constraint must be recognized by policymakers in both countries and in supranational bodies. If institution building has some maximum rate of accomplishment built into the process as the ability of ordinary people to accommodate (institutional) change approaches its limit, then the recognition of that constraint must be explicitly identified in the decision-making process.

INWARD FDI AND THE ENVIRONMENT[50]

The thrust of this paper has been that for both I-D countries and, where possible, for stagnating countries inward direct investment is the preferable for-

[47] This is most clearly seen when the inward FDI is seeking to exploit (depletable) primary resources. Here it is essential that the host government have the inherent skills to negotiate an agreement with the foreign corporation that retains for the host country the Ricardian rent which belongs to the primary resources.

[48] "Japanese Aid to Jakarta to shift to Technical Expertise", *The Straits Times*, 13, November, 1999.

[49] The emphasis on the financial sector in this paper should not be seen as refuting the generality of the argument.

[50] This section draws heavily on OECD (1999), particularly the articles by Gentry and Zarsky.

eign conduit for financing sustainable development.[51] This raises the question of how direct investment can be expected to affect the two objectives of sustainable development other than growth in per-capita income: the preservation or improvement of the environment — reducing the *rate* of environmental depredation — and the development of desirable social programs. It is important to recognize, at this juncture, that any analysis of the effect of FDI on environmental depredation requires that a distinction be drawn between the direct and the indirect effects. The operations resulting from inward FDI generate the direct effect (for example, emissions from factories of affiliates of multinational enterprises (MNEs) or the side-effects of mining a primary resource) and the environmental repercussions of any induced economic growth constitute the indirect effects. A part of any consumption pollution brought about by economic growth may be offset by the reduction of some pollution generated by sheer pressure on resources. Clearly, the indirect effects are likely to include the generation of desirable social programs as well as increased pollution generated by additional consumption.[52] Since the indirect effects are unlikely to be very sensitive to the cause of economic growth (domestically-generated growth or FDI-induced growth) and since economic growth is seen as inherently desirable, this section does not explore the potential indirect effects.[53]

There exist both favourable and unfavourable direct effects. Simple logic suggests that countries seeking to attract inward FDI will regard sacrificing environmental quality as one of many possible incentives which can be offered to internationally-mobile investments. This possibility suggests that these developing countries will become pollution havens and that their environmental quality will be sacrificed for the sake of FDI-generated economic growth.[54] The reverse of this possibility is that established affiliates will transfer to the host nation production processes from the parent corporation and affiliates in more environmentally-sensitive economies and, in the process, reduce the total rate of environmental depredation in the host.

Examples of both kinds of FDI can be found, of course, but it is difficult to substantiate the predominance of either, in part because the generation of reliable data is extremely difficult.[55] There is also a wide range of possible ways in which pollution can be measured and different measures are likely to provide conflicting results. The problems are enhanced when MNEs based in environmentally-sensitive countries attempt to preserve the image of being environmentally friendly by subcontracting out the "dirty" production processes to other, possibly host-country firms. This is referred to as "cascading pollution". Zarsky (OECD 1999) finds evidence that supports both hypotheses. In an attempt to clarify the puzzle, Zarsky (OECD 1999, 52-57) develops a conceptual framework of linkages of which the macro linkages are the most important. The most pessimistic of these is the inability of national or supranational governments to control the behaviour of firms whose activities are internationally-mobile in a world in which poor countries cry out for sources of greater output and the regulation of pollution generation has been consigned to the level of individual states. In some countries, voters have relatively short time horizons so that longer-term problems, such as environmental depredation, are not given the attention they deserve. This concern echoes Kindleberger's (1986) concern with the lack of international public goods in the modern global economy. While recognizing the problems of both analysis and policy, it is worth noting that MNEs are, as a major global phenomenon, less than fifty years old: the society of nations has not yet addressed, with any degree of commitment, the problem of how to regulate the environmental implications of MNEs at the global level. Concern over the environment is necessarily urgent but there is need for commitment rather than despair. The beginnings of such a commitment are to be seen in the growth in the political strength of the environmentally concerned in the more affluent countries.

[51] ODA possibly excepted for the stagnating countries unable to attract adequate amounts of inward FDI.

[52] OECD (1999, 15) seems unduly concerned with the indirect effects: "This approach recognizes that although an investment might be judged 'environmentally-friendly' at the plant level, its operations may contribute to a larger-scale of economic activity at the macro level, which may in turn lead to additional environmental harms". If the source of net environmental damage is generated by the induced economic growth (an indirect effect), this implies that growth is harmful *per se* — unless the role of cascading pollution is important (see below). The argument reverts back to the point made in the first footnote to the effect that poverty elimination had become the "poor stepchild" of the annual CSD sessions.

[53] It is certainly possible, and even probable, that the establishment of foreign affiliate enterprises will give impetus to the improvement of the quality of socio-economic infrastructure – partly by spillovers from the affiliates' activities and partly by increasing the need for higher quality infrastructure.

[54] Given the fungibility among the various investment incentives and performance requirements, environmental quality may be sacrificed not only in terms of the affiliate's operations but also in terms of the mix of incentives offered (Gray and Walter, 1983).

[55] One way to improve the quality of empirical studies is to generate a series of interview-based studies at the industry level such as Lundan's (1996) study of the pulp and paper industry.

There is general agreement that MNEs from environmentally-sensitive countries are more likely to create "environmentally-friendly" affiliates because of the need to maintain a good environmental image in their home country and in other markets in which they compete. Concern for an MNE's general reputation can be an important lever for governments and non-government organizations (NGOs) which seek to ensure that FDI in developing countries is not motivated by the search for pollution havens. Perhaps more important in efforts to ensure that FDI is environmentally-friendly is that any lack (or waiver) of environmental regulation in a country which attracts an exporting affiliate be seen as an implicit subsidy of "dirty production". In this way, the goods produced by the affiliate would be subject to countervailing duties on importation into an environmentally-friendly country (Lundan, 1996, Chap. 2).

Other factors which limit the potential of the polluter haven hypothesis is that cost savings from dirty production are more likely to be realized in countries which are badly in need of inward FDI. Often, industries that would manage to effect substantial cost savings from lax enforcement of environmental controls tend to be heavily capital-intensive so that the exposure to political risk and similar socio-economic weaknesses in potential host countries is substantial.

While Gentry (1999, 37-42) analyses the various options open to governments and NGOs in industrialized countries to exert some control over the degree of environmental depredation which can be exercised by affiliate enterprises, the OECD volume refers only tangentially to the level of socio-economic infrastructure available in host countries. In addition to a lack of voter concern in some countries, the world operates seemingly as a series of independent states so that there is no major collective political understanding and commitments.

To regulate an industry or to put together a winning incentive package calls for a sophisticated set of institutions. These institutions are most likely to be found in I-D countries in which the willingness to cater to pollution-unfriendly processes is likely to be small (or, at least, significantly smaller than in stagnating countries). Since "dirty production" can be seen as an implicit subsidy, affiliates in a pollution haven will be limited to countries in which the affiliate is market-seeking. Countries with sufficiently large domestic markets are I-D countries and will not be sufficiently desperate for inward FDI that they will subsidize polluting industries.

CONCLUSIONS

Reliance on the (private) corporate sector to be the key actor in achieving the goals of the Commission on Sustainable Development will not be adequate. The dichotomy of developing countries into those making steady progress and those in stagnation identifies a group of poor countries that have not yet reached the level of sophistication in institutional infrastructure needed to attract substantial inward FDI or private portfolio investment. This conclusion does not mean that the corporate sector cannot play the major role in the further development of countries which have achieved (even low levels of) sustainable development and these are the countries which we have assumed to be most likely to divert a substantial part of incremental income to social programmes and environmental protection.

Models of economic development have not sufficiently emphasized the need for adequate institutional infrastructure, particularly financial infrastructure. This may be due, in part, to the predilection of economists for analyses which fail to recognize instability in financial markets and interruptions in the development process because of malfunctions of any kind.

It is recognized that many of the countries that are currently stagnating may not have institutional infrastructure which allows them to utilize adequately inflows of ODA. While governments and super-national global institutions may be responsible for the distribution of ODA, it would be valuable for the Commission on Sustainable Development to confront the question not only of how the volume of ODA can be increased but also to develop some criteria which might serve to guide the distribution of ODA among the stagnating economies.■

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ATTRACTING CAPITAL INFLOWS TO AFRICA: ESSENTIAL ELEMENTS OF A POLICY PACKAGE

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EXECUTIVE SUMMARY

While Latin American and Asian economies have been recipients of large inflows of private foreign capital in the 1990s, Africa has been largely left out of this net private flow to developing economies. As a result, Africa continues to rely primarily on ODA flows to close the domestic savings-investment gap.

Negative investor perceptions are part of the problem. Attracting private capital to Sub-Saharan Africa (SSA) is complicated by negative investor perceptions about the region in general. There is a tendency to lump African countries together as part of a continent that carries high risks to investments and thus is unattractive to potential investors.

This paper analyses those policies that can help promote inward foreign investment into Africa to take advantage of the surge in cross-border flows into developing countries since the 1990s, while being mindful of some of the dangers this can present. The paper recognises that not all African countries are the same: there are characteristics and historical or colonial linkages that give advantages to some countries with regard to FDI and other capital inflows.

Among the most significant impediments to inward investment is political risk (whether perceived or real) and the fact that reforms in Africa seem to take considerable time to enhance the credibility of governments. This is often the result of several serious policy reversals in the past. Therefore, policies that promote transparency and allow for checks and balances against executive power will help to build credibility in the institutions and public offices of African countries. Institutional reform should include strengthening the judiciary and its ability to enforce the rule of law, and providing for an independent central bank for the promotion of monetary stability. Policy credibility can also be enhanced by external mechanisms of restraint through linkages with the European Union and other trading areas. This would be pursued in conjunction with rationalising and strengthening regional trade arrangements intended to increase market size. African countries should also reduce costs of doing business in the region by improving the quality of public infrastructure, investing in people and reducing corruption. But most important is the commitment to ensuring macroeconomic stability and continued reform of the African economies. This is critical for attracting sustainable long-term foreign investment to Africa.

Africa may not currently be a major recipient of inward investment, but the future promises enhanced integration into the global capital market as long as Africa can improve its investment climate.

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INTRODUCTION

WHILE Latin American and Asian economies have been recipients of large inflows of foreign capital in the 1990s, Africa has been largely left out of this net flow of capital to developing economies. For example, African and Middle Eastern countries received less than 10 per cent of FDI flows to developing countries. In the case of portfolio flows, Africa received an even lower share of net flows to developing nations — in 1996 it was 1.6 per cent (World Bank, 1999a). As a result, Africa continues to rely on ODA flows for the lion's share of capital inflows to close the domestic savings-investment gap.

Official flows (including grants and debt-service) to SSA have averaged approximately 5 per cent of GNP over the period 1990-95 while the average is one per cent for all developing countries (World Bank, 1996). According to 1999 estimates by the Organisation for Economic Co-operation and Development (OECD) Development Assistance Committee (DAC), total official development assistance declined for five successive years prior to 1998. In 1998 it increased by $3.2 billion to $51.5 billion, equivalent to 0.23 per cent of total donor country GDP (World Bank, 2000). The increase in official development assistance in 1998 is mainly associated with the rescue packages for East Asia and Russia. Otherwise the projections point to a decline in 1999. As budget constraints in donor countries become more severe, these flows are expected to fall further in the medium to long-term, while in the short-term conditionalities on their utilisation become stricter and therefore restrict the freedom of recipient countries to choose how funds are utilised. Therefore, it is essential that Africa attracts larger share of private capital flows to finance its development. This is by no means a simple task, or one that can be achieved overnight, but as a first step policy measures need to be identified which can achieve this goal. Beyond this, the task of implementing policy measures is potentially even more difficult.

Even when reforms are successfully implemented, the ability of policymakers to attract private capital to SSA countries is complicated by negative investor perceptions about the region in general. UNCTAD (1995) has the following comment on the issue: "although several countries in Africa have an investment climate that is good, a number of potential investors lump them together with other countries, and see them as part of a continent that is considered not to be attractive for transnational corporations, especially if compared with competing locations in the worldwide FDI market". While a considerable body of literature exists for the Latin American experience with capital flows, and some for East Asia, studies focusing on Africa are virtually non-existent — exceptions include Asea and Reinhart (1995) and Kasekende and Hussain (1997). The areas examined in this literature include the scale and composition of capital flows, their implications for macroeconomic management and their causes and sustainability, among others. This paper identifies those factors that can best encourage capital inflows to Africa, with a special focus on the policy measures that should be taken by governments. The paper also highlights efficient and productive ways in which foreign inflows can be utilised in financing development and ensuring sustained improvements in well-being as measured (rather crudely) by economic growth. Examples will be presented from Uganda's recent experience in the utilisation of foreign inflows.

MEASURING CAPITAL INFLOWS IN SUB-SAHARAN AFRICA

There are considerable difficulties in interpreting the data on capital flows to Africa. Often there is a lack of resources for the monitoring and recording of capital flows resulting in poor data quality. Some countries have kept a hands-off approach in the new liberalised environment so as to avoid sending the wrong signal to investors, who may believe (wrongly) that the old regime of control still exists. Some capital controls remain, but these have been easily circumvented. For example, in order to avoid capital account restrictions, some transactions are misrecorded as current transactions.

The composition of inflows to Africa is skewed towards those types that are most difficult to measure. The outcome has been that inflows to SSA countries have been under-recorded and this has been exacerbated by the absence of recording systems. In some African countries private transfers have reached high levels, such as 9 per cent of GDP in Tanzania and 4 per cent in Uganda (Helleiner, 1998), but it has been difficult to break them down into their constituent parts. Almost certainly some part of these private transfers represents capital account flows. Kasekende and Hussain (1997) find that including private transfers in the measurement of capital flows for Kenya, Uganda, Tanzania, Zambia and Zimbabwe increases them from an average 1.1 per cent of GDP for the period 1986-1993 to 4 per cent. Indeed, the inclusion of private transfers accounts for most of the increase in capital flows to these countries over the period 1990-1993 compared to 1986-1989. It is certainly possible that the increase in recorded private transfers is in fact a recovery, at least partially, in unrecorded foreign direct investment into these Sub-Saharan African economies. In the case of Uganda, the increase in private transfers is partly explained by the return of flight capital and returning Asians (Kasekende and Hussain, 1997).

While there are certainly difficulties in identifying the constituent parts of private transfers, on the whole, Sub-Saharan Africa continues to lag behind

Table 1. Composition of Private Capital Inflows to Developing Countries, (per cent)

	1978-82			*1990-93*		
	Latin America	*Asia*	*Sub-Saharan Africa*	*Latin America*	*Asia*	*Sub-Saharan Africa*
FDI	15.1	15.0	9.8	33.0	37.5	140.3
Portfolio	4.9	3.6	0.0	68.1	14.2	10.9
Long-term bank loans	63.6	53.9	53.9	-32.1	21.7	-143.5
Short-term loans	16.4	27.5	36.3	30.5	27.0	92.3

Source: IMF, *International Financial Statistics*, various issues; and World Bank, *World Debt Tables*, various issues

other developing regions of the world in attracting foreign capital inflows, especially in absolute terms. World Bank estimates based on capital account and debt/equity inflows indicate that during 1990-94 inflows averaged more than $180 billion a year. Of these, only $16 billion a year went to SSA countries.

Notwithstanding the above, Africa played host to increased levels of private capital inflows in the period 1994 to 1997. In that period, private capital inflows increased by a factor slightly higher than three from $4.8 billion to $16.3 billion (Kasekende and Kitabare, 1998). This was mainly on account of increased levels of foreign direct investment and other net investments. Kasekende and Hussain (1997) established that inflows to Africa, and especially to Sub-Saharan Africa, amounted to levels, measured in relation to GDP, comparable to flows to other developing countries. Indeed, the debate on the possible causes and the challenges to macroeconomic management of increased capital inflows was being considered as part of broader policy measures to sustain growth and promote macroeconomic stability. Apart from the potential adverse impact of these inflows, the recipients of private capital were able to finance higher levels of private sector investment rates. Uganda is a clear case where levels of investment well above its savings rate are largely financed by both private and public foreign savings.

In response to the East Asian crisis, developing countries in general suffered a contraction in private sector inflows. Private inflows to developing countries declined in both 1997 and 1998 from $212.1 billion in 1996 to $149.1 billion in 1997 and to $64.3 billion in 1998 (World Bank, 1999b). The decline largely affected the Asian countries, which suffered massive reversals of inflows in both 1997 and 1998. With the exception of South Africa, Africa largely survived the negative impact of the East Asian crisis on inflows due to the limited integration of their financial markets into the global capital markets. Indeed, FDI and net portfolio flows in 1998 were recorded at levels comparable to 1996. The issue then is how does Africa prepare itself for higher levels of volatility that may be associated with a deeper integration into the international capital markets.

CAUSES OF CAPITAL INFLOWS

Before putting together a policy package designed to attract foreign capital it is first necessary to identify factors that can achieve this goal. The literature groups the factors that attract foreign capital into two groups: external "push factors" and domestic "pull factors". Among the "pull" factors are:

- economic and political reforms that boost confidence in the economy;
- reforms such as debt restructuring which ease the long-run foreign exchange constraint and therefore enhance the sustainability of foreign exchange inflows;
- liberalisation of foreign exchange flows (both current and capital) in the balance of payments;
- simplification of red-tape requirements for direct and portfolio investment; and
- liberalisation of restrictions on private sector borrowing from abroad.

Among the "push" factors are:

- the relative decline in international interest rates (mostly US dollar rates) when compared to interest rates in developing economies;
- cyclical downturns in economic activity in developed economies, which reduce the demand for investment funds; and

- a move towards international diversification of asset portfolios by major portfolio investors such as pension funds and insurance companies.

The literature identified both push and pull factors as being behind the increase in capital flows to developing economies in the 1990s (for example, Asea and Reinhart, 1995). However, it is domestic or "pull" factors over which policy-makers can have a direct impact in attracting inflows of private capital.

THE POLICY PACKAGE

While public investment rates in Africa are comparable to those in other developing countries, private investment rates are much lower (Collier and Gunning, 1999). In a world of mobile capital, capital should flow to those areas where returns are highest. But while returns in Africa are high in nominal terms, in risk-adjusted terms they may not be, suggesting that reducing the risk factors in Africa can help attract more foreign capital. A policy package that reduces risk factors to foreign investment should also be able to deal with many of the risk factors that result in low levels of domestic private investment.

Reducing Political Risk

Enhancing the credibility of reforms

The international image that Africa has is one of unstable governments, military coups and abrupt policy reversals. Moreover, Sub-Saharan Africa seems to be seen as one homogeneous continent and therefore the bad behaviour of a few governments often leads to a negative image for all. Evidence from surveys suggests that policy reversal is regarded by investors (both domestic and foreign) as the main component of overall investment risk (Collier and Gunning, 1999). This is reflected in sovereign credit ratings for Africa. Although there are no formal credit ratings available for SSA outside South Africa, a number of agencies (among them the Economist Intelligence Unit) provide a measure for sovereign credit risk. Political and policy risk are given the largest single weight in the overall rating. However, most of the available measures have a large subjective element in their calculations (Bhinda and Martin, 1994) which bias the ratings downward.

Actions by governments that increase uncertainty (especially policy reversals) are particularly bad for attracting foreign capital. Uncertainty complicates long-term planning and deters investments that require large initial start-up costs or would entail large exit costs in the event of upheaval. Hadjmichael and others (1996, 29) concludes, "the most important impact of policies on private investment behaviour was through their effect on macroeconomic stability and uncertainty".

Policy reversals in the past have also made it more difficult for present Governments to credibly commit to reforms today. Building credibility is likely to take time while potential investors take a wait and see attitude. For example, in Uganda, even though the law on the return of property to their Asian owners was passed in the early 1980s, it was not until the late 1980s and early 1990s that Asians began to return in numbers.

Credibility also matters for the sustainability of reforms. Reforms that are credible are more likely to be sustainable in the long-run as economic agents react positively to policy measures and result in a virtuous circle of behaviour. For example, a credible programme of reforms can lead to increased domestic and foreign investment creating employment and tax revenues that can be used to cushion some of the costs of reform. When reforms lack credibility the intended benefits may take much longer to materialise while the costs of reform mount. Those sections of the population that are most burdened with the social costs of reforms may successfully lobby for policy reversal. Therefore, it is essential that reforms undertaken by governments have the support of the people from the very beginning and that there is a dialogue between interested parties and governments.

There may be mechanisms of restraint, both external and internal, that reduce the ex-ante probability of reversal and thereby increase the credibility of the reform process itself. External restraints might include conditionalities on foreign aid or membership of, and signatory to, international organisations such as the World Trade Organisation (WTO) which limit the ability of governments to impose discretionary measures such as increases in import duties, for example. However, on aid conditionality, Burnside and Dollar (1997) find that during a period of generally increasing aid conditionality there was, in fact, a deterioration of country risk ratings in Africa. This may be why the Highly Indebted Poor Countries (HIPC) Initiative is provided for only those countries that have implemented policy reforms over a sustained period.

Internal restraints include providing the central bank with legal independence, which would go a long way to ensure that monetary policy is free from political interference. According to Collier and Gunning (1999), internal restraints may be weaker because of autocratic behaviour by African presidents in the past. Measures should also be put in place that enhance judiciary independence so that it can operate without political interference. This will also ensure that politicians operate within the law, and where they do not, the judiciary can act as a check. An example is the recent impeachment of several Ministers in President Yoweri Museveni's Government in Uganda by Parliamentary majority. Such checks and balances are welcome developments, providing for effective monitoring of Government actions.

Political reform

Political disorder is very damaging to economic growth (Chege, 1999) and is not a conducive environment for both domestic and foreign investment. Political reform should be aimed at building frameworks that are more inclusive, encourage power-sharing and allow for enhanced public participation in the political process. There should be room for political debate; opposition groups should be given official recognition under the law. Lack of access to television and radio and other forms of communication, which unfairly limit the ability of opposition views to campaign for support, can lead to alternative, including violent, forms of struggle. In fact, peaceful conflict resolution is a key ingredient to maintaining stability in African economies. This has been demonstrated by recent conflicts in the Great Lakes involving several African countries.

Chege (1999) emphasises the need to reform political institutions in Africa as a basis for consolidating the reforms, mostly economic, which have been undertaken. It should also be noted that a high degree of ethnic diversity has not necessarily translated into greater conflict in African countries. As in any society, there will be conflicts over the distribution of power and resources, which, in Africa, most often works along tribal lines. Whether the outcome is peaceful or disorderly will depend upon the ability of the institutions of governance to resolve conflict peacefully. These institutions should be able to operate in an objective environment where decisions are made according to the law.

Inclusiveness in Africa does not have to mean Western style democracy. Institutions and the system of government should aim to be inclusive but in a way that accounts for the particular ethnic and religious characteristics of the individual country. For example, the Movement System since the National Resistance Movement took power in 1986 has served Uganda well and is expected to be a transitional phase to full multi-party democracy.

Experience from different multi-party elections in Africa in the 1990s shows that the results have not always been beneficial to the country concerned. It seems that tribal loyalty has translated into party loyalty along the same lines (Chege 1999). This means that multi-party democracy has merely transferred the potential for division along tribal lines to political parties. What is needed, in addition to free and fair elections, is a system of government and institutions that is inclusive to minorities. The political process should not be used as a convenient means of marginalising minority parties (tribes) using the cloak of multi-party elections. This will require careful consideration of the unique ethnic and religious characteristics of each country so that reforms are tailored to ensure a pluralistic and civil society that is able to minimise and peacefully resolve conflict.

Insurance against policy risk

Countries can sign bilateral or multilateral investment treaties that have legally binding elements establishing the obligations of the host country toward foreign investors from other signatory countries. These can help to ensure continuity in the environment under which foreign investors operate and also to limit the power of governments to renege on their promises. These mechanisms can also be used to resolve disputes. One example is the International Centre for the Settlement of Investment Disputes, a multilateral institution that is part of the World Bank group, which provides a mechanism for arbitrating investment disputes amongst member countries.

Such mechanisms should enhance the credibility of other complimentary reforms in areas affecting foreign investors. African governments should carefully consider signing multilateral and bilateral arrangements that can promote their own goals of attracting foreign investment, while not subjecting them to undesirable commitments that might otherwise be part of some of these arrangements.

Ensuring Macroeconomic Stability

Macroeconomic stability is a prerequisite for attracting sustainable, long-term foreign investment into a country. Hadjmichael and others (1996) conclude "the most important impact of policies on private investment behaviour was through their effect on macroeconomic instability and uncertainty". This suggests that greater macroeconomic instability can have a considerable adverse impact on domestic and foreign private investment.

A considerable amount has been achieved in the area of establishing a stable macroeconomic environment. In 1997, 33 countries recorded inflation rates less than 10 per cent compared to just 12 in 1994 (African Development Bank, 1998). But, much needs to be done to consolidate these improvements and to ensure that those countries which continue to perform poorly carry out the necessary reforms. Continued improvements in macroeconomic performance — low inflation, low and sustainable budget deficits, stable but competitive exchange rates — will help to enhance the overall environment in which private investment is conducted. For example, low budget deficits ensure that the private sector is not crowded out of the market for credit, and a stable and competitive exchange rate reduces uncertainty and ensures export competitiveness.

Macroeconomic Policies

Reducing the burden of external debt

In many African countries external debt servicing, most of it official, continues to exact a significant burden on finances. At the end of 1994, the total debt stock was $164 billion, in present value terms, of which 17 per cent was owed to private creditors, 64 per cent to official creditors and 19 percent to multilateral institutions (Claessens and others, 1996). Resources that might otherwise be used to invest in public infrastructure, education and health have to be used to service external debt, often in circumstances where foreign reserves are low and have to be rationed.

In principle, heavy external debt does not automatically translate into low growth. Growth in export earnings can allow for continued importation of investment goods to maintain growth while servicing external debt at the same time. However, for reasons of solvency, this process cannot go on forever. There are two possible end scenarios; an orderly crisis-free resolution where foreign exchange earnings are generated by investments made using borrowed foreign money in the first place. However, if borrowed money is invested primarily in the non-traded sector, then a situation will arise where the economy is unable to pay for imports required to maintain growth. In these circumstances, the authorities may be forced to apply foreign exchange controls to limit the availability of foreign exchange for "non-priority" areas, including the ability of foreign investors to repatriate earnings and dividends. If private investors conclude that this end scenario will take place, it can induce a "rush for the exit" that brings forward such a crisis. This type of conclusion is most certainly affecting investor perceptions today about Africa.

A heavy debt burden can also hinder a country's ability to restore confidence in its domestic economy and credibility to its reform programme. The adjustments required to restore debt to sustainable levels are usually painful and, for this reason, may not be credible. For instance, those groups worst affected by the adjustment may be politically able to roll back some of the changes.

The HIPC Initiative has gone some way in reducing the debt-service burden to sustainable levels for heavily indebted poor countries that have a track record of implementing sound economic policies. These countries are required to invest the savings made from HIPC relief in priority areas such as health and education. As mentioned previously, improvements in human capital should be part of any process to encourage private capital inflows to Africa. But, in general, reforms should have significant local participation in their design to ensure that local ownership is maximised. This will enhance the long-run sustainability of reforms.

Capital account convertibility

Although many countries have made progress in eliminating capital account restrictions relating to long-term flows, a number of African countries continue to have restrictions relating to FDI and the repatriation of foreign exchange (IMF, 1999). These clearly do not help investor confidence in these countries.

Freeing-up capital account transactions can send a positive signal to the investment community about government intentions towards foreign investment; why would a government expose itself to a sudden flight of capital when confidence deteriorates, unless it has inside knowledge about its own strong commitment to reform?

Opening up the capital account should be carefully sequenced so that it is sustainable. The experience of East Asia has shown that the financial sector and supervisory authorities have to be effective in managing capital inflows during boom years, to ensure that returns generated by the investments into which they flow are able to service the future external obligations.

Investment in Public Infrastructure

"The low capacity of infrastructure, institutions and human capital constitute major underlying development challenges in the continent" (Africa Development Bank, 1998). This was stated as part of four broad sets of issues constraining private sector investment in Africa. This is one rationale for the present policy under the HIPC Initiative to direct savings from debt relief to social programmes such as health and education. Here the term public infrastructure is used in its broadest sense to include institutions, human capital as well as physical infrastructure such as roads.

Infrastructure investment

Inadequate public infrastructure reduces the return to private investment since they are complementary. For example, poor roads increase the cost of transporting goods to the market-place and may even make the supply unpredictable if they cause more frequent breakdown of vehicles. If the demand for these goods is price elastic it becomes more difficult for the producer to pass on the costs to the consumer. In the case of Uganda, recent survey evidence from private sector firms revealed that the power sector was a serious constraint to doing business (Reinikka and Svensson, 1998). An unreliable and costly power supply means that private businesses are often forced to invest in private generators, which further increases the costs of doing business.

Building Sound Institutions

When foreign investors arrive they are likely to meet several government agencies along the path to finally starting up operations, and such agencies can have a considerable impact on the final decision of whether or not to invest. The cost of doing business increases when such institutions are very inefficient or require bribes to provide incentives for “fast-track” clearance. Other examples are slow and bureaucratic procedures in applications for investment licenses. Therefore, institutions need to be effective at providing the services they are designed for, and in a manner that is fair. Discretionary application of rules and procedures reduces confidence in public institutions and can lead to attempts to circumvent them or abuse them to gain unfair advantage (such as offering bribes). As part of a plan to encourage FDI, Bhinda and Martin (1994) recommend that tax and duty structures and levels should be made more transparent to encourage greater compliance.

Legal and regulatory environment

A fair and efficient legal system is essential in ensuring that all economic agents are treated fairly and that there exists an effective mechanism for resolving conflict. Legal rights (property rights, for instance) must be upheld, and the rule of law should prevail. Such a system can then act as a restraint against abuse of power by the executive arm of government, and a check against reversals of policies that are enshrined in the law. These mechanisms are designed to reduce the institutional uncertainty that any investor, whether domestic or foreign, faces when planning ahead and deciding whether or not to invest.

Africa’s legal institutions suffer from a lack of credibility. Collier and Gunning (1999) report that African courts generally work less reliably than elsewhere, while only about a quarter of African lawyers consider the judiciary to be fully independent of the executive. This, in turn, often leads to less reliance on the courts to resolve conflict. That is why legal reforms to provide for an independent judiciary and a fair legal system for conflict resolution are essential in rebuilding credibility. These institutions should be provided with sufficient human and physical resources to carry out their duties.

Microeconomic and Sectoral Policies

Macroeconomic policies alone are unlikely to effectively promote foreign investment. Complementary microeconomic policies at the industry and firm level can play a critical role in providing incentives for foreign investors.

Tourism

Tourism is potentially a significant source of foreign inflows. Africa’s vast natural resources, such as the game reserves and national parks, are the biggest attraction for foreign visitors that distinguishes Africa from other tourist centres. Tourism should be promoted in a way that safeguards the long-term viability of the continent's natural resources. Some of the income from national parks and game reserves could be used to improve the monitoring and safeguarding of animal populations against threats such as poaching.

Investment promotion centres

Investment promotion centres can, at their very simplest, take the form of international trade missions to countries that are potential inward investors, or the setting up of agencies designed specifically to speed up the clearance of procedures for inward investment. At the other end of the spectrum, they may be export promotion zones that provide for concessionary tax rates, tax holidays and other incentives.

Investor missions can have significant benefits if they are well targeted and organised to deliver a consistent and favourable message. Potential investors should be clearly identified and targeted and then missions should introduce opportunities to them that they are currently not aware of. This requires skilled communication and a well thought out strategy on the part of agencies such as investment authorities. On the other hand, if such missions are seen as lacking focus by foreign investors they may do more harm than good to a country’s investment image.

This type of marketing has been seen in trade and investment missions from developed countries. They usually involve a high level politician (such as the minister for trade) and chief executives of top tier companies from the host country.

Export promotion zones

Export Promotion Zones (EPZs) are areas demarcated to provide various incentives to attract both domestic and foreign investment into export sectors. These incentives include tax exemptions on profits, favourable utility prices and guaranteed service provision and reduced red tape, among others. The essential question is whether such preferential treatment provides for a net benefit to the country over some specified time horizon. The initial costs to government can be high in the form of foregone tax revenue and utility provision. It may also be difficult to judge whether the resulting investment would have taken place anyway in the absence of the EPZs; governments would not want to provide incentives for those foreign investments that would take place even in the absence of specific incentives such as tax holidays.

But while EPZs may be costly in the short-run, they contribute significant positive externalities in the form of technology and management skill spillovers. Other benefits include increased employment and skill acquisition through training and development. The use of the EPZ in Mauritius has resulted in strong links between the domestic textile industry and textile producers in Hong Kong, China. In the case of countries like Uganda, EPZs could help to strengthen links between domestic investors and

Asian investors.

Encouraging joint ventures

In a joint venture, the local partner is likely to have a comparative advantage over its foreign partner with regard to information about local market conditions, bureaucratic procedures and contacts with local customers. The foreign partner may bring new and improved managerial skills to the relationship and have access to financing that may not be available to the local partner, as well as new technologies and processes being used in overseas markets. These synergies can help to overcome fears that foreign investors may have when investing in new markets and benefit the local partner in the form of a more rapid transfer of skills and technology.

In Africa, there is a paucity of information about local conditions, and this information gap may be enough to deter potential investment. So long as the legal relationship between partners is properly defined and laid out, joint ventures can be one way to encourage foreign investment, at least in the early stages of entry of foreign investors.

However, a number of safeguards should be put in place, which allow for equal participation for the local and foreign partner. For example, it should not be the case that foreign partners are not allowed to have voting rights on the board of directors of a company simply because they are from a foreign entity. Policies that are designed to simply attract foreign investment without providing for a stake in the decision-making processes are very likely to fail to deliver the intended benefits.

Strengthening the Financial Sector

The financial sector plays an important role in the management and sustainability of capital inflows. In Africa, the banking sector dominates the financial sector. Inflows of foreign capital can enhance the deposit base of banks and consequently their ability to expand their loan portfolio. If this happens too quickly, and internal monitoring and control systems are unable to manage such an expansion, a large share of these loans may become non-performing, eventually threatening the solvency of the bank.

Foreign inflows also present foreign exchange risks for banks. While the liability is in foreign currency, the corresponding asset will be in domestic currency. If the entity holding the loan has most of its revenues denominated in domestic currency, it will be subject to the risk of a depreciation in the domestic currency versus the foreign currency, which increases the cost of servicing the foreign currency loan. Such risks need to be effectively managed both internally and by external supervision by the Central Bank or other supervisory authority.

Foreign capital can flow into a country in several ways depending on the nature and purpose of the original inflow itself. For example, portfolio flows are more likely to flow into the country if there is a broad-based and liquid stock exchange where equity can be traded. Indeed, where a fledgling stock market exists, foreign capital can enhance liquidity and diversify equity holdings. However, one danger that has been highlighted by recent events in Latin America and East Asia is that short-term portfolio flows can be subject to sudden reversal, causing an exchange rate crisis.

Regional Co-operation

The small size of most African markets has often been highlighted as a disincentive for foreign investment that requires a minimum market size before it is profitable. Regional trade agreements that lower barriers to trade, by eliminating tariff and non-tariff barriers, can potentially solve this problem. Presently, within the Cross-Border Initiative in Eastern and Southern Africa there are five different Regional Trade Arrangements or RTAs (IMF, 1999). Member countries have to deal with conflicting objectives between these RTAs, different strategies for liberalising trade and investment, and conflicting rules and administrative procedures. The goal of facilitating cross-border activity would benefit from a harmonisation of the goals and objectives of the different RTAs, at the very least. A better solution would be to rationalise the structure of the overlapping RTAs, and consolidate them into fewer entities or one single entity. It would then be easier to align objectives and goals, allowing for more co-ordinated implementation of agreements while ensuring objectives are internally consistent.

When regional groupings are not clear, potential investors can find it difficult to identify market opportunities. Complicated structures usually involve larger amounts of red tape requiring more investment in expertise in the areas of taxation and legal procedures, which increases the cost of doing business.

Encouraging Links with South African Companies and Investors

Encouraging tie-ups with South African investors may be another promising avenue for attracting foreign capital. South African enterprises have been “moving north” into other African countries in wide ranging areas, from mining to brewing. Within the Sub-Saharan region, South Africa has a better record of attracting foreign investment. This is partly the result of having a better image in the international community and the fact that the transition to the post apartheid period has been relatively smooth and peaceful.

South Africa could potentially be a conduit foreign direct investment to the rest of Africa. Geographical and historical links give South African entrepreneurs and companies expert regional knowledge about the risks and benefits of investing in various areas and sectors around SSA. This kind of reliable information about African investments can potentially solve the problem of market failure by providing for credible signals to potential foreign investors about the viability of different investment projects or proposals. Funds, which would not otherwise have been invested in various projects, could then take advantage of this superior knowledge.

South Africa also benefits from superior brand names when compared to other countries. This is helped by the fact that within SSA, South Africa is home to the largest number of multinational companies.

CLOSING THE SAVINGS-INVESTMENT GAP AND SUSTAINING GROWTH

Capital inflows can help to close a deficit savings-investment gap in a country and is one of the major reasons why they are important for countries in Africa, which are mostly in deficit. Calamitsis and Dhonte (1996, 1) state that "…to achieve gains in real per capita GDP an expansion in private savings and investment is key". In this respect, to generate and sustain growth in Africa, investment in physical and human capital is crucial, but with the current low levels of the domestic savings rate much of this will have to be financed with foreign surplus capital (see table 2). Over the period recorded in the table and most recently, it is official development assistance that has enabled total investment to be consistently higher than total domestic savings, with private investment and savings mostly in line with each other.

As discussed previously, there are various preconditions that are necessary before foreign investors (both private and public) are willing to invest. The lack of these conditions in the past has discouraged foreign investment in Africa. Reforms have included liberalisation of the foreign exchange regime. In the 1970's, with a very poor political and economic environment in much of Africa, capital flight was a major constraint to economic activity. Foreign exchange was rationed by central banks. This severely limited the importation of key spare parts that could only be found abroad and generally constrained the level of economic activity to those areas that were deemed to be essential. In these circumstances official development assistance was mainly used for the purposes of importing essential goods and services.

More recently, there have been significant reform efforts in various African countries and this has been associated with a return of flight capital and new inward foreign direct investment. In Uganda, for example, the response from private sector investment underlines this return of confidence, having risen from 7.6 per cent of GDP in 1986 to 11.1 per cent in 1995-96. This has been associated with a considerable pick-up in private transfers—they were only $1 million in 1986-87 but increased to an estimated $510 million in 1996-97 (Kasekende and Kitabire, 1998). Such private sector inflows have eased the foreign exchange constraint for countries such as Uganda that have undergone a sustained reform effort and stabilised the macroeconomic environment. The trade deficit is now largely financed by private sector receipts of foreign exchange recorded in the current and capital accounts, while official development assistance has allowed the central bank to build up foreign reserves with the local equivalent amount being spent by government ministries on social sector development projects. Within the area of development expenditure, health and education projects have been major recipients of external official development assistance. This should, in the long-term, allow for more balanced growth, with private sector inflows financing imports of physical capital while Government expenditure, financed by ODA flows, are channelled to the development of human and social capital.

An easing of the external financing of investment expenditure on inputs of production and investment has enabled the Ugandan economy to enjoy high rates of economic growth in the 1990s (averaging 7 per cent). In the earlier part of this period, economic growth resulted mainly in higher rates of capacity utilisation. The earlier period of conflict and civil unrest resulted, not only in capacity destruction, both human and physical, but also in a large fall in economic activity and therefore an increase in spare capacity. As spare capacity falls, additional growth will have to come from capital formation. Arguably, this is more difficult to achieve than the simple utilisation of spare capacity, and will require high rates of investment on a sustained basis. Given Uganda's present low savings rate, the next phase of growth will rely more heavily on foreign investment (private and official). Domestic savings rates should then respond to higher levels of income generated by these investments, and structural policies that encourage saving.

Ghana is another example of a country in Africa having recently undergone reforms. In Ghana, too, net private transfers increased substantially during their Economic Recovery Programme. There were small outflows during 1983-86, but by 1987-91 average annual inflows of private transfers had increased to $200 million, equivalent to approximately 3.5 per cent of GDP (Nowak and others, 1996, 37). Taken together, net external financing (official and private) more than doubled — from $172 million in 1983-86 to $472 million in 1987-91. This considerably eased the external constraint on growth and investments in Ghana.

If private capital inflows generate a virtuous circle of increased investment that generates income and

Table 2. Trends in savings and investment in Sub-Saharan Africa, 1986-92 (per cent of GDP)

	1986	*1987*	*1988*	*1989*	*1990*	*1991*	*1992*
Total domestic saving	10.3	11.6	10.9	12.0	14.0	13.3	11.9
Total investment	17.0	18.3	18.7	17.5	18.4	19.4	18.8
Private saving	8.1	10.9	11.6	11.8	12.8	11.8	12.1
Private investment	8.4	9.2	10.2	9.7	10.6	10.8	10.3

Source: IMF, Economic Trends in Africa database, August 1993

savings and leads to more investment, there will be considerable other benefits. For example, expanding economic activity requires larger amounts of labour. This can help to provide employment to previously idle labour, and in turn generate tax revenues that can be spent by government and invested in social sectors such as health and education.

CONCLUSIONS

The paper has shown that a confluence of factors will help Sub-Saharan Africa attract capital inflows. These factors include both economic and non-economic factors. But it is not necessarily the case that all these factors will come into play for Sub-Saharan Africa to generate increased capital inflows. Recent experience has shown that a strong commitment to eliminating distortions in the macroeconomic environment has caused a reversal of flows to the benefit of the reforming countries. To sustain and increase those inflows requires continuous restructuring of the economies to eliminate residual distortions, as well as investing in institutional reform, including strengthening the judiciary and political institutions. This would help to change negative perceptions about Africa and reduce the risk of policy reversal and the cost of doing business. The paper has also shown that factors constraining domestic investments, such as poor public infrastructure, equally discourage foreign investment. There is a need to address impediments to investments, in general, for Africa to attract higher levels of inward investment.

Regional integration has been identified as critical for eliminating constraints associated with the limited size of most of African economies. SSA should therefore move quickly to rationalise the structure of overlapping regional integration groups to benefit from such trading blocs. Related to this are the increasing investments originating from South Africa in the rest of SSA. This is a very welcome development that should be fully harnessed.

The paper has presented the potential benefits of increased capital inflows to Sub-Saharan Africa. Such inflows would ease the foreign exchange constraint that affected a number of countries during the 1970s and 1980s. Consequently, countries would be able to finance higher levels of imports while building foreign exchange reserves. In addition, countries would be able to sustain levels of investment higher than what can be sustained by domestic levels of savings. This would enhance growth prospects and economic performance of countries benefiting from higher inward capital inflows. More importantly, such countries would reduce poverty levels as employment of resources increases.■

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THE IMPACT OF REGIONALISATION IN THE AFRICAN CAPITAL MARKETS SECTOR AND THE MOBILISATION OF FOREIGN CAPITAL FOR SUSTAINABLE DEVELOPMENT

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EXECUTIVE SUMMARY

Successful consolidation of African countries in large regional economic blocs is now a reality with such successful blocs as the Common Market of East and Southern Africa (COMESA), the Economic Community of West African States (ECOWAS) and the South African Development Community (SADC). As world markets operate more and more like "global villages," corporations search relentlessly for investment opportunities with the lowest production cost, lowest cost of capital, highest investment returns and lowest risk both within and between these "villages". The consolidation of regional capital markets, combined with a coherent environment conducive to investment, is imperative if African countries are to participate in the global economy.

Stock markets, in general, are about options. For savers, the stock market provides an alternative to the money currently placed with the local bank. For entrepreneurs, governments or corporate bodies, the market provides a venue to raise capital to finance projects or businesses. For Africa to attract significant foreign direct investment, the stock markets will also be increasingly used as a platform by foreign investors to raise more capital to finance projects.

Currently, there are twenty stock exchanges in Africa, which represents about a 40 per cent increase in market capitalisation over the past five years—the increase rises to 160 per cent if the Johannesburg Stock Exchange (JSE) is included. This is an impressive achievement by any standard. However, most African stock markets are characterised by low liquidity due, in part, to poor micro- and macro-structures from central governments. Despite this, on average, African stock exchanges have out-performed most emerging and developed markets for the past ten years. This is in line with the increase in the overall level of foreign and direct investment and increases in the privatisation of state-owned utilities, private sector investment and the overall level of investor confidence.

For the exchanges in Africa to maintain high levels of sustained growth rates, the venture capital market sector needs to be developed further. African stock exchanges are still mainly dominated by major international institutions in the banking and insurance sectors. African governments will need to create the right conditions for budding entrepreneurs to raise capital in the markets. The right regulatory framework, greater transparency, protection for investors, less corruption and less state intervention are some of the vital ingredients that will have to be in place before investors can take the African stock exchanges seriously. At the moment, a significant number of exchanges have gone some way towards putting most of the above requirements in place.

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INTRODUCTION

AFRICA has experienced significant economic growth in the 1990s. However, the role African capital markets played in this sustained growth and development is not yet well established. One of the reasons is that the majority of Africans do not yet understand the basic functions of the stock market. African governments, for their part, still do not have coherent policies in place to push forward the capital markets agenda. For Africa to attract significant foreign direct investment, the stock markets will need to be used as platforms by foreign investors to raise capital to finance their projects. Exchanges will also need to be used by budding entrepreneurs as venues to raise venture capital to help finance their businesses. One of the key reasons why the capital markets sector has received little attention by development organisations is the general perception that stock exchanges do not, immediately, help combat poverty and diseases. It is, however, not difficult to see that well regulated stock markets will help improve cross-border trade and spread wealth across borders and, as a result, create jobs.

There are currently 20 stock exchanges in Africa located in Botswana, Côte d'Ivoire, Egypt, Ghana, Kenya, Malawi, Mauritius, Morocco, Mozambique, Namibia, Nigeria, South Africa (three exchanges), Swaziland, Tanzania, Tunisia, Uganda, Zambia and Zimbabwe. One more new exchange is expected to be operating in Lesotho soon (African Stock Exchanges Handbook, 1999). The Johannesburg Stock Exchange in South Africa is the continent's largest stock exchange with a stock market capitalisation (SMC) of $170 billion (as at year end, 1998) and the developing world's third largest behind Hong Kong and Taiwan. It is among the most technologically advanced exchanges and accounts for about a fifth of the stock market capitalisation of all stock markets in Africa.

In recent years, African markets have, on average, out-performed all leading market indicators. Emerging markets specialists believe this is just the beginning of an even greater performance from Africa's fledgling stock markets. This is both optimistic and simplistic, but positive feelings have led some fund managers to back those feelings with cash by investing in the region. A recent example is the Southern Africa unit trust, from Save & Prosper, the retail fund arm of the merchant bank Robert Fleming, which raised £10 million. Others include the Africa Investment fund from US investment bank Morgan Stanley, which raised £230 million, and Baring Asset Management, a UK fund management company.

Of the few African funds that exist, most of the money is invested in South Africa. Yet, spectacular opportunities are more likely to be found in other African markets. Great possibilities lie in the small and, as yet, under-researched countries, which have only set up their stock exchanges since the mid-1980s. The S&P fund is typical, though, as it put 85-90 per cent of its cash in South Africa and the remaining 10-15 per cent in Zimbabwe and Botswana. It is also typical in that it will invest in a mix of quoted and unquoted companies as well as some fixed interest securities.

The change in world politics since the collapse of communism has created a background of opportunity within African capital markets. The fall of Soviet power around the world meant that African nations were forced to take notice of the capitalist approach attached to loans from institutions such as the International Monetary Fund and the World Bank. As a result, since the mid-1980s, many states have undertaken programmes designed to strengthen their economies, moving away from central planning and towards a more conventional capitalist model. This is something that potential investors have looked favourably on. Typically, the World Bank insists that governments agree to fulfil a number of criteria before it will make loans. These include the implementation of floating exchange rates, cutting government spending, liberalising interest rates, following a tight monetary policy and creating a broader tax base, all conditions in which private sector capital can be used for investment and development. Cutting government debt by privatising state-owned companies is another typical pre-condition. Not surprisingly, these are also some of the very conditions necessary for a stock market to function efficiently.

STOCK MARKETS: GROWTH POTENTIAL

African stock markets are still in their development phase. However, many emerging market specialists believe that these are the last undiscovered stock markets in the world. There has been some significant undervaluation of African stock markets over a number of years. This undervaluation has been, consequently, translated by most analysts into an out-performance of the African stock market indices relative to other emerging stock market indices even without a substantial foreign investor base. Once a substantial foreign investor base emerges, this out-performance will be significantly magnified.

During the period from January 1994 to August 1998, the U.S. dollar denominated Flemings Africa Index including South Africa (FAiSA) returned 22 per cent while the International Finance Corporation (IFC) Investable Composite Index (IFCI) lost 43 per cent. In the same period the Flemings Africa Index excluding South Africa (FAxSA) returned 169 per cent or a compounded annualised return of 21 per cent per annum. The FAxSA outperformed the S & P 500 Index by 12 per cent. The returns for both the FAiSA and the FAxSA significantly outperformed the returns of the S&P 500, the IFCI Composite and the regional IFC indices for Asia, Europe, the Middle

East and Latin America during these periods. For the 12-month period ending April 30, 1998, the top two performing stock markets in the world were African markets. The stock market in Ghana was up 165 per cent in dollar terms for this period making it the world's best performing stock exchange during this period. The market in Botswana was up 94 per cent in dollar terms during the same 12-month period making Botswana the world's second best performing stock market.

The combined stock market capitalisation (SMC) of African stock exchanges almost doubled from $136 billion in 1989 to $225 billion at the end of 1998. This rise in SMC value is magnified further when one considers the rise in the SMC value for African exchanges, excluding South Africa, from $5 billion to $55 billion during the same period, an eleven-fold increase. It should also be noted that the African share of emerging market SMC has also increased from 3.7 per cent in 1985 to 12.7 per cent in 1996. ING Barings, the international investment bank, projects that the combined SMC of African countries will increase by a factor of five or six by the year 2010. This figure will increase significantly with proper regional blocs in place.

Another positive factor that characterises African stock markets is the very low correlation between African stock markets and the major stock markets. Furthermore, apart from this low correlation (in many cases, even negative correlation) between African markets and the major world markets, there is also very low correlation between African markets themselves. This is due to the economic diversification of African markets. This is unlike markets in the Asian and Latin American regions where intra-regional correlation is high. This combination makes Africa a truly diversified addition to a global portfolio. The situation could, however, change with greater regionalisation of the markets.

The IFC recently provided seed capital for the launch of a West African Fund and has added many African emerging markets to its emerging market indices. Morgan Stanley, through its Morgan Stanley Capital International (MSCI) affiliate, also launched, in late 1997, two Africa Indices (MSCI Egypt and MSCI Morocco), thus bringing to three the number of markets covered by the MSCI, with South Africa being the third market. Furthermore, the IFC, in its Emerging Markets Database (EMDB), covers eleven African markets and includes five (Egypt, Morocco, Nigeria, South Africa and Zimbabwe) in its IFC Global Composite Index (IFCG). The other six markets covered by the IFC include Botswana, Côte d'Ivoire, Ghana, Kenya, Mauritius and Tunisia and are included in the IFCG Frontier Composite Index.

The IFC eloquently summarises the rationale for investment in the African stock markets with the following positive comments: "Africa is the new frontier … (and its) economic potential is largely untapped. Its plentiful resources have been enhanced by economic and political progress over the last decade… Africa presents a tremendous potential market… the game is just starting in Africa and willing players… will have their just rewards. The rewards of investing in Africa justify the high risks. Returns… have been among the highest in the world and the outlook is good" (IFC, undated, 3-4).

REGIONALISATION OF AFRICAN CAPITAL MARKETS

International trade and investment flows have increased more rapidly than world GDP over the last two decades. This rapid growth of international transactions has sometimes been referred to as "globalisation". However, it has been argued that globalisation has not contributed to overall world growth, but only benefited a small number of countries while many others have failed to reap the benefits of rapid increases in international trade and investment flows; that is, that the globalisation process leads to a concentration of trade and investment flows and greater inequality.

For the African capital markets, the way forward is through the formation of strong regional blocs, which will then, ultimately, lead to a meaningful global agenda. The question is, will regionalisation improve the overall performances of the African stock exchanges? Globalisation and regionalisation are not necessarily antagonistic, but rather mutually reinforcing. African stock exchanges need to integrate with the rest of the world and, in doing so, they must first come together and establish their own regional blocs.

Regionalisation is currently taking place in the continent. In fact, the world's first regional exchange is the *Bourse Regional de Valeurs Mobiliéres* (BRVM) in Abidjan, Côte d'Ivoire, which commenced trading in early September 1998. The BRVM will serve the eight French speaking West African countries – Benin, Burkina Faso, Guinea-Bissau, Côte d'Ivoire, Mali, Niger, Senegal and Togo. It is expected that five to ten companies from each of the eight BRVM member countries will be listed on the BRVM. The BRVM will use electronic trading and settlement (T+3) systems. The eight member nations of the BRVM will be connected via satellite.

There are also currently plans for two other regional exchanges in Africa — one in anglophone West Africa (Nigeria and Ghana) and the other in East Africa (Kenya, Uganda and Tanzania). These exchanges will increase market liquidity while, simultaneously, stimulating the addition of substantial depth to the capital markets in these African sub-regions. During a meeting in Johannesburg this year, leaders of the SADC stock exchanges resolved to speed up the linking of their trading, clearing and settlement systems with the aim of building the region's market into a world contender. The Namibian stock exchange is already linked to the Johannesburg stock exchange.

As a way forward and for stronger regional co-operation between the SADC exchanges, plans were in place to bring the Johannesburg Stock Exchange, the Bond Exchange of South Africa and the South African Futures Exchange (SAFEX) under one umbrella. However, both the Bond Exchange and SAFEX rejected the planned merger, put forward by JSE, during separate meetings on 24 November 1999. This is a blow to the spirit of regionalisation in the SADC region. It is, however, hoped that the three exchanges will work more closely together in the future.

The Johannesburg Stock Exchange and the Nigerian Stock Exchange have also signed a memorandum of understanding, which will encourage technology transfer, staff secondment, dual and new listings and training between the two exchanges. The implications of the "bloc-effect" are far reaching. What this simply means is that financiers in Europe or North America interested in investing in Africa will find it easier to do business in these regional stock market blocs. Foreign direct investment (FDI) will grow as a result. More importantly, it will be easier for investors in countries within blocs to raise capital in the region to expand their businesses. For instance, an investor from Ghana will encounter fewer problems raising money from the Nigerian Stock Market to set up a business in Côte d'Ivoire.

One feature of many African stock exchanges, as a result of their relative youth, is the advanced technology in place in these exchanges; many of these exchanges were formed at a time when the technological development of trading and settlement systems was already advanced.

In today's world, no nation can realise its full economic potential on its own. Cross-border and regional co-operation will maximise prosperity for each of the member states in the continent, as is the case for other regions of the world. Africa has much to learn from the European Union, which is increasingly focusing on the private sector as the engine of growth and on the establishment of a free trade area. To be active participants in the new world order, African countries have to liberalise their financial markets, reduce price support and subsidy programmes, and direct resources to more efficient projects (IMF, 1999).

The continent already has a number of active and well-structured economic blocs. These include, among others, ECOWAS, COMESA and SADC. These blocs will play key roles in the regionalisation of the capital markets. The Organisation for African Unity (OAU) also actively promotes trade and investment among African countries and hopes to spark the creation of an African common market in the next decade. A common aim of all these blocs is to unify the varying tariffs between African countries and to expand inter-African trade. This, if successful, will make trading across the various exchanges easier and more cost effective. Furthermore, the free market would not be confined to commercial trade but will also aim to promote the free flow of capital and investment among member countries.

Asia's financial crisis has been a dominant theme in almost every recent professional gathering. What exactly precipitated the Asian crisis? Without being too simplistic, a heavier reliance on debt rather than equity might be the major cause of the crisis. Corporations and financial institutions were focusing on attaining growth targets without being accountable to discerning shareholders, and that led to inefficiencies and excesses. Of course, this was accentuated by a set of other structural problems, namely inadequate regulations and insufficient transparency among banks, corporations and the governments. Another consequence was an excess inflow of private capital, some of which was channelled into unproductive investments leading to excess capacity and financial market over-valuations.

The crisis in Southeast Asia had very little effect on the African region's capital markets, except for South Africa. This was partly due to the fact that there were relatively few foreign capital investments into the African capital markets. The Sub-Saharan region attracted less than three per cent of all private capital flows to developing countries over the past seven years. The channels for speculation in Sub-Saharan markets are not available, with no futures or options markets (South Africa excluded) to facilitate short-selling of the region's currencies or stock markets. Regionalisation could dramatically improve the derivatives and foreign exchange markets which are non-existent in most African markets.

THE ROLE OF GOVERNMENT AND THE PRIVATE SECTOR

The distribution of international capital is being conducted in a very discretionary way, leaving Africa on the sideline. Competition to attract foreign investment is intensifying as emerging stock exchanges adopt development strategies based on increased integration in the world markets. Thus, for the African markets to survive well into the next millennium, it is important that the respective governments in the region put in place sound fiscal and monetary policies. This should be accompanied by macro-economic reforms that will bolster investor confidence, build a strong supervisory and regulatory infrastructure, help cultivate modern risk-management techniques within the private sector, put more emphasis on privatisation, and help to open the economies to foreign participation with bold trade and financial sector liberalisation to improve efficiency (Collier, 1997).

Many leading private institutions are strong players in their home markets but are only small operators in the regional and global arena. Forming strategic alliances or expanding regional presence, through mergers and acquisitions, is a way to overcome this handicap. Businesses and financial institutions should create regional companies and services to expedite the process of the region's integration. Corporate sector reforms should involve the improvement of corporate disclosure and accounting standards to facilitate the move to a market-driven investment culture.

It is very important for the protection of individual investors that only stockbrokers who are licensed and regulated by particular stock exchanges are used to transact investment business. Such stockbrokers would also be conversant with current legislation and be able to advise investors accordingly. International Standard Securities are such a firm of stockbrokers.

Potential investors have to believe that relevant policy changes put in place regarding market regulations and the role of government will be adhered to. So far, most countries that have agreed to programmes have stuck to them. South Africa is proving to be a major success story, and this is now encouraging investors to look at other parts of Africa they may previously not have considered.

The World Bank anticipates that the economies of sub-Saharan Africa will grow at a rate of 3.9 per cent a year from now until 2003, boosted by inter-regional trade and a recovery in commodity prices. There is a strong body of opinion that believes that to get the best returns investors must get into African stocks as soon as possible and in markets other than South Africa. This is easier said than done. Apart from South Africa and Egypt, most of the exchanges have fewer than 50 quoted companies, with more than 80 per cent of each market's worth concentrated in its top 10 stocks. Most of those are the African subsidiaries of multinationals, such as Barclays, Unilever, Mobil and Standard Chartered. With the advent of universal Internet use, this is beginning to change. The lack of information has always proved a barrier to external investment for Africa and the Internet provides a window into the continent for external investors.

Possibilities now exist for the flotation of African companies in external markets, offering tremendous potential profit for investors. There are obvious pitfalls, but the risks have to be balanced against the possible rewards. Ghana has headed the pack with the flotation in the London markets of Ashanti Goldfields, in which the government had a 55 per cent stake and Lonrho the remainder. In the early 1980s, the mine had been run down to a fifth of current production because exchange controls had forced it to stop investing in new equipment. Since the mid-1980s the mine has been transformed, allowing the government to sell 27 per cent of the company for £1.1 billion to help repay foreign debt. However, a recent major forward exchange transaction, which went terribly wrong, cost the company millions of dollars. This is the other side of market liberalisation. South African companies listed in foreign markets include Old Mutual and South African Breweries. M-Net, another South African company, will soon be listed on the Nigerian Stock Exchange. Further opportunities exist in the continuing privatisation programme in Ghana. Morocco has state companies worth £2 billion earmarked for public listing. There are also active privatisation programmes in Uganda.

Many countries, such as Zimbabwe, Ghana and Botswana, now allow foreigners to buy at least part of a company and to repatriate dividends. Others demand authorisation before a foreigner can deal. Most African countries still don't have markets. There is plenty of scope for Africa to justify the perception of being the last great emerging market.

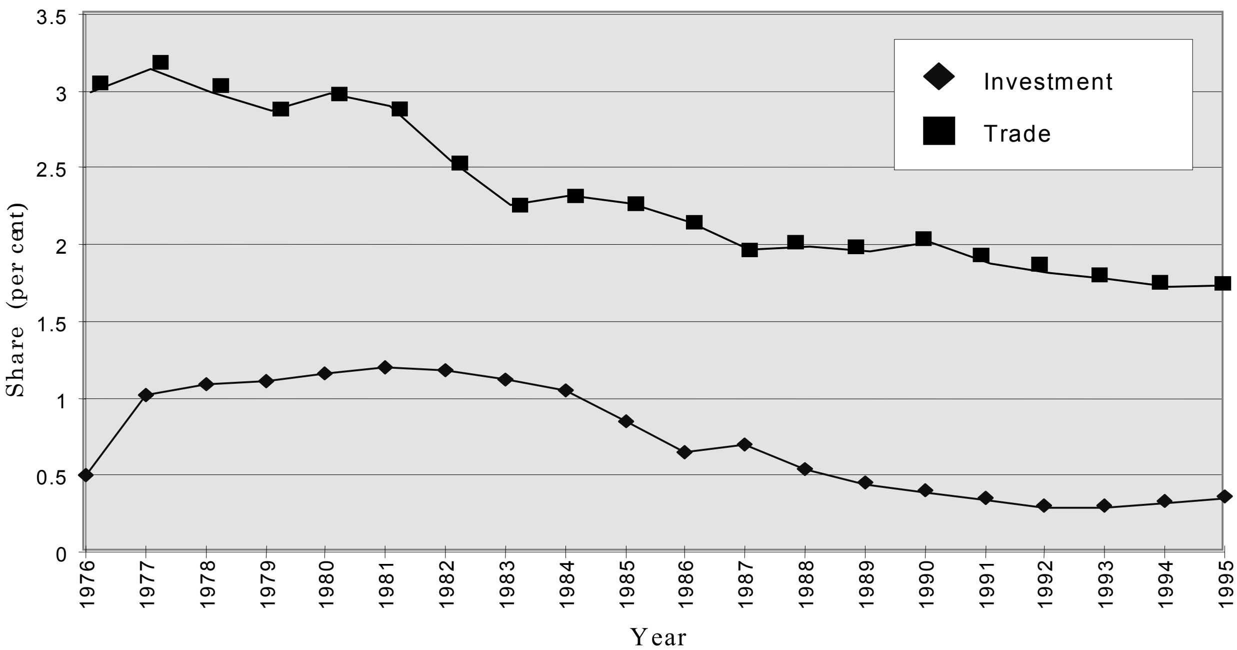
IMPACT OF FOREIGN DIRECT INVESTMENT

It is becoming increasingly clear that Africa must attract significant foreign investment flows to supplement the continent's low domestic savings rate. This will necessitate a higher level of integration between African financial systems and global financial markets which, in turn, would require improved financial information, lower business and currency risk, and financial infrastructure and regulations acceptable to major foreign institutions. African financial markets provide enormous opportunities for the continent to achieve higher economic growth. Free capital movements will facilitate the allocation of savings and channel resources into productive uses, thus promoting sustainable development. Open financial accounts will support the multilateral trading system by broadening the channel through which countries can finance trade and attain higher levels of income (Bhattacharya, Monteil and Sharma, 1997). Regional financial flows will, no doubt, expand opportunities for portfolio diversification and provide investors in both industrial and African countries with the potential to earn higher rates of return on their investments. Unfortunately, liberalised financial markets can also lead to sharp and unpredictable reversals of capital flows. Volatility in capital flows was the main cause for the financial crises in 1997 and 1998.

These crises, with their unacceptably high financial and development costs, raise concerns about the net benefits of international capital flows into Africa. Africa experienced declines in both total world trade and investment flows from 1984 to 1995 (figure 1). Current estimates, however, show marked improvement in both variables.

In the continent, the percentage increase of private loans from banks is still low or negative and this has an adverse effect on private capital flows into the capital markets. After the debt crisis of the 1980s, most commercial banks are cautious about providing loans to investors, as they are still trying to recover previous loans. It should, however, be emphasised that African economies, with the exception of Nigeria

Figure 1: Sub-Saharan Countries Shares of World Trade and Investment Flows, 1976-1995



Source: World Trade Organisation, (1996). Annual Report.

and Côte d'Ivoire, borrowed mostly from multilateral organisations such as the World Bank. Portfolio equity flows are also still small but growing. Foreign direct investment has increased, especially in non-CFA countries, with positive per capita growth in some African countries, for instance in Botswana, Ghana and Mozambique. Their growth is a powerful signal of rising investor interest and confidence. Since 1994, twelve Africa-oriented funds have emerged to manage about two billion dollars in assets. Examples include the Morgan Stanley Africa Growth Fund, the New Africa Investment Fund, and the Calvert Africa Fund. In addition, the focus of these funds has expanded from South Africa to Botswana, Côte d'Ivoire, Ghana, Kenya, Mauritius, Zambia, and Zimbabwe. For African stock exchanges, the benefits are clear: improved liquidity, greater incentives for privatisation, increased incentives for policy reforms and improvement of financial infrastructure.

There are a number of factors that dent investor confidence. These include political instability and weak macroeconomic fundamentals, weak or low growth, the size of markets, and a high degree of inward orientation. Structurally, factors that inhibit investment include heavy regulations, corruption, slow progress on privatisation, limitations on the number of listed private firms, a limited pool of investable assets, poor infrastructure, high production costs, and high indebtedness. To ensure that African stock exchanges continue to attract private investment, it is vital that African policy makers claim as their own a reform agenda that, among other things, calls for microeconomic and macroeconomic reforms.

Microeconomic reforms. Microeconomic reforms to reduce transaction costs and combat corruption are essential for the smooth running of emerging stock markets. For example, there is a need to put efficient securities trading systems in place. There is also a need for computerisation of clearing systems that would allow securities to clear within hours. A number of countries have already embarked in that direction. A significant amount of legal reform also needs to take place in order to ensure that transaction distortions are minimised. For example, corporate laws need to be reformed to allow more transactions like mergers and acquisitions, bankruptcies, and leveraged buyouts. The broader goal is to improve the transparency of property rights laws. For the long term, African governments should encourage their best firms to explore listing on international exchanges, which often have more stringent disclosure and accounting requirements. Aside from exposing these firms to global best practice, it creates knowledge spillovers and a broader investor perception of the listing firms' home economy.

Macroeconomic reforms. According to Olson (1996), it is ineffective to consider even minimal development in isolation of specific macroeconomic issues. The synchronisation of infrastructure is necessary, at the national level, to strengthen policies, payments and regulations in the capital markets sector. The establishment of a regional capital market requires the absence of restrictions on capital movements and on dividends and profits, together with the harmonisation of general taxation, regulatory and legal requirements as a framework that could be used to launch them. Policy makers need to put more emphasis on raising output growth, emphasising the need for openness, ensuring relative stability of real effective exchange rates, and maintaining low external debt (Porter, 1993). These are conditions that foster high investment rates by domestic and international investors. At the same time, African governments need to embark on wider privatisation of state-owned enterprises. Far too many investors complain that not enough has been done to reduce the role of the state in the capital markets.

Are there any useful lessons that sub-Saharan African exchanges can learn from the East Asian crisis? There are four potential lessons, all linked to the efficient functioning of the financial system.

First, if a government senses that its financial institutions are developing problems, it should not hesitate to decisively tackle the problem before it leads to an implosion of the relevant economy. For example, the Nigerian government's recent decision to close insolvent banks was prudent because their poor performance would hamper the effectiveness of other well-run banks. It is important that a financial system allocate credit efficiently.

A second lesson centres on the question of central bank independence. The ability of central bankers to focus on single objectives such as price stability is a virtue that feeds into maintaining general macroeconomic stability. Equally importantly, it signals to investors and other economic actors that the government's capacity to intervene in economic management for a variety of reasons is severely constrained.

A third lesson is on the need for an efficient financial system regulatory infrastructure. One of the strengths of the American financial system is the regulatory excellence of the Federal Reserve Bank System. Numerous teams of bank examiners and regulators are able to spot flaws in the financial system that could be detrimental to the U.S economy, and potentially the global economy. One of the criticisms levelled against Southeast Asia's economies is the weak regulatory structure for monitoring bank activity. In the presence of a better regulatory system, the maturity and interest mismatch and numerous bad loans, which plagued those institutions, may have been spotted much earlier, before they wrecked havoc. In many countries, the need for well-trained and capitalised bank regulators and examiners is underestimated until the financial system approaches collapse under the weight of bad loans.

Fourth, so long as one is willing to examine the evidence, it becomes clear that balance of payments crises are often self-induced. Blaming the IMF will do no good.

THE IMPACT OF VENTURE CAPITAL

Banking systems are inherently conservative and status quo oriented. But conservative approaches are not enough if developing stock exchanges are to help reduce poverty. Mechanisms are needed to channel resources to the highest potential payoff, even though the risk may be higher than for traditional uses. Small businesses with no credit history need funding for expansion so they can grow into large businesses. African stock markets could provide the medium for such businesses to raise capital. There is, therefore, a need for risk capital for people with ideas and capabilities who need financing. Historically, much risk capital has come from wealthier people who know the potential users personally. Extended families play this role in many cases. Among religious or ethnic minorities, group solidarity is often helpful. Indeed, the great economic success of some groups results in part from their ability to mobilise resources within the community for promising enterprises. Larger firms, often suppliers, in an industry also may provide capital to new, smaller firms when they know the new firms' capabilities or potential.

For the most part, however, budding entrepreneurs lack access to capital from these sources. If they are to obtain capital, it must come from a source with which they have no personal acquaintance. This is where venture capital enters the development business. A venture capital financier looks for promising enterprises to back with funding and limited technical advice, perhaps for a considerable period of time. If the enterprise fails, the financier simply loses his stake. If it succeeds, the financier has acquired an equity stake in the company that allows him to benefit in proportion to the success and, sometimes, far out of proportion to his initial investment.

This need for venture capital is not limited to developing countries. The United States has the most developed venture capital industry in the world. Venture capital activity is aimed primarily at small and medium enterprises. Large enterprises are a different matter as they have the capital base and visibility that make them candidates for conventional lending, as well as bond sales and equity sales on a broad scale. At the moment, the venture capital sector within the African stock exchanges is almost non-existent, largely because large companies mainly dominate the markets. This sector, if developed, will go a long way to improving liquidity in the stock exchanges.

FACTORS THAT PROMOTE MARKET EFFICENCY

In general, there are several key factors which can promote and improve efficiency in the African capital markets sector:

Improved environment. Trade liberalisation, strengthening of the rule of law, improved legal and support institutions, better governance, improved transparency and better transport and telecommunications have helped to make it easier to do business in many African countries.

Economic reform. Many African countries have stabilised their economies, sometimes through the devaluation of overvalued currencies. They are reducing inflation rates and cutting budget deficits. Others are raising educational standards and, more generally, upgrading their human and technological resources.

Private sector encouragement. Many countries are stimulating economic growth by making life easier for the private sector. At least twenty African countries have broad-based privatisation programmes in place. When one looks at particular sectors, the number is even bigger. Some 25 countries in Sub-Saharan Africa are transferring all, or part, of their telecommunications ownership from the state to the private sector. In South Africa, for example, Telekom Malaysia, together with SBC Communications from the United States, has invested $1.2 billion in Telkom South Africa. The results of the privatisation efforts in Africa are already visible. Countries in which privatisation has attracted significant FDI include Ghana, Mozambique and Uganda.

Better FDI regulatory framework. The great majority of countries have substantially improved their FDI regulatory frameworks. Many more countries now allow profits to be repatriated freely or offer tax incentives and similar inducements to foreign investors. Many African countries have investment promotion agencies (IPAs) to assist these investors.

Venture capital provision. Small and medium sized companies constitute about 90 per cent of the businesses in Africa. Of this, a significant portion represents the informal sector. The small business and informal sectors do not, traditionally, have adequate access to credit facilities. A diversion of some FDI into the small business sector and helping the informal sector with a portion of ODA would help create jobs and improve the quality of life for the poor.

CONCLUSIONS

The achievement of sustainable development in the African capital markets sector requires an increase in investment, particularly foreign direct investment and micro-financing through venture capital. This will require both the maintenance of a stable macroeconomic environment and far-reaching improvements in governance. There will be a need fior discipline and transparency in the capital markets sector. The world is starting to rethink Africa's role in global markets. The challenge African stock exchanges will be facing in the near future is how to exploit the growing investor interest in their markets to create a virtuous cycle of growth. Secondly, the task for all African governments is to strengthen the institutional architecture of their economies to prevent capital flight and to minimise its consequences when it does take place. To effectively tackle these challenges, the management of the various African stock markets will have to:

- persuade their respective governments to stop interfering with the market because it sends out the wrong signals when governments want to be market regulators and participants at the same time;
- actively encourage investment in Africa. Africa needs to sell itself better to foreign investors;
- help create markets where it is easy to buy and sell securities and thus instil confidence in investors;
- help reduce corruption and promote regional integration and stability. Africa is seen abroad as being endemically corrupt and war-torn. It does the market a lot of harm when corruption and regional conflicts are regarded as the two core African values;
- help improve the legal framework. Securities laws have to be more effective and courts more impartial;
- help create the conditions for venture capital instruments. Venture capital will go a long way in helping small- and medium-sized companies to raise capital; and
- encourage new stock listings to improve investors' choices.

In general, African countries need to pursue policies that would allow them to efficiently tap into global financial market integration. It is logical to deduce that initial reactions to capital inflow will largely shape the patterns of future responses. African governments on their part will have to understand that:

- there is wisdom in curbing lending booms associated with capital inflows while redesigning the institutional structure of the financial system;
- it is wise to develop a well-functioning financial system to reduce the risks of potential instability as well as to attract global portfolio investment;
- developing countries need to build better shock absorbers and develop mechanisms to respond to instability because they will remain highly vulnerable to external shocks for quite sometime; and
- international co-operation between regulators and adequate disclosure of information at all levels are

increasingly important to ensure safe and efficient markets.■

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