# AFRICAN DEVELOPMENT REPORT 2001

# A SUMMARY

**AFRICA IN THE WORLD ECONOMY**

**FOSTERING GOOD GOV ERNANCE IN AFRICA**

**ECONOMIC AND SOCIAL STATISTICS ON AFRICA**

**THE AFRICAN DEVELOPMENT BANK**

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# Contents of the African Development Report 2001

# SUMMARY

# African Development Report 2001

## Introduction

The *African Development Report 2001* reviews Africa's current socio-economic performance and prospects, and examines in-depth the issues and elements of fostering good governance in the continent. The issues and elements of fostering governance examined include politics, conflicts and corruption; economic and corporate governance; global dimensions of governance; and Bank Group Policy on governance. The Report also provides the main economic and social statistics on Africa. The Summary highlights the main aspects of the Report.

## The African Economy in 2000

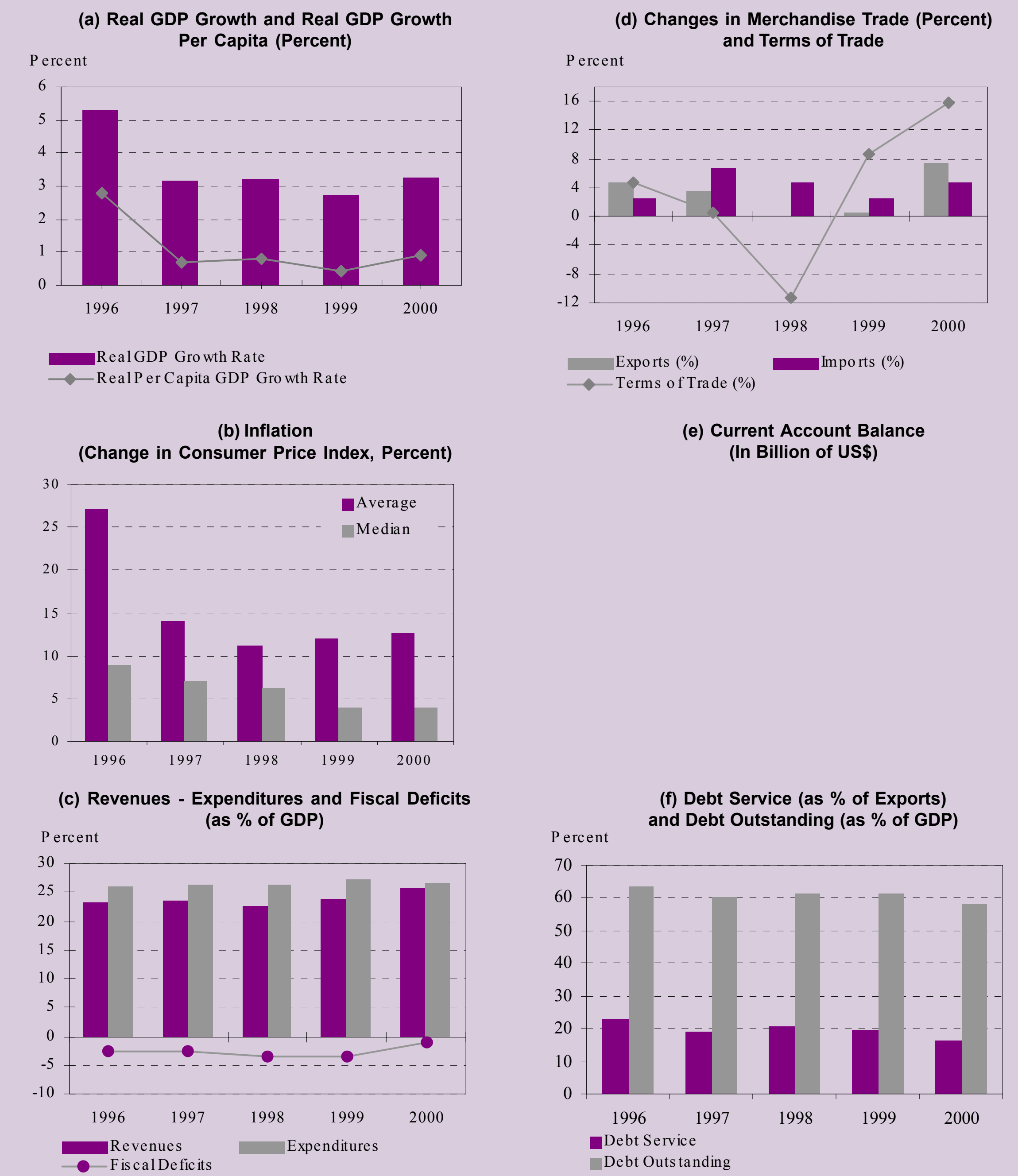
After slowing to 2.7 percent in 1999, real GDP growth in Africa recovered modestly to an estimated 3.2 percent in 2000 (Table 1, Figure 1). Rebounds in the region's major economies, particularly the oil exporters, and the continued strength in some of the smaller economies led the recovery. Other factors that drove the recov-

**Table 1: Africa: Macroeconomic Indicators, 1996- 2001**

| Indicators | 1996 | 1997 | 1998 | 1999 | 2000[a/] | 2001[b/] |
|---|---|---|---|---|---|---|
| 1. Real GDP Growth Rate | 5.3 | 3.2 | 3.2 | 2.7 | 3.2 | 4.1 |
| 2. Real Per Capita GDP Growth Rate | 2.8 | 0.7 | 0.8 | 0.4 | 0.9 | 1.8 |
| 3. Inflation (%) | 27.0 | 14.1 | 11.2 | 12.0 | 12.7 | 10.2 |
| 4. Investment Ratio (% of GDP) | 18.1 | 18.2 | 20.2 | 20.4 | 19.9 | 20.3 |
| 5. Fiscal Balance (% of GDP) | -2.6 | -2.7 | -3.6 | -3.4 | -1.0 | -1.3 |
| 6. Growth of Money Supply (%) | 18.7 | 17.5 | 14.2 | 17.9 | 13.4 | 10.9 |
| 7. Export Growth, volume (%) | 4.7 | 3.6 | 0.0 | 0.6 | 7.3 | 5.3 |
| 8. Import Growth, volume (%) | 2.5 | 6.8 | 4.7 | 2.6 | 4.8 | 5.1 |
| 9. Terms of Trade (%) | 4.8 | 0.6 | -11.3 | 8.6 | 15.7 | -5.8 |
| 10. Trade Balance ($ billion) | 4.8 | 2.2 | -17.5 | -10.4 | 11.4 | 2.9 |
| 11. Current Account ($ billion) | -5.3 | -6.4 | -24.6 | -18.5 | -2.0 | -8.6 |
| 12. Current Account (% of GDP) | -1.0 | -1.2 | -4.5 | -3.4 | -0.3 | -1.4 |
| 13. Debt Service (% of Exports) | 22.9 | 19.2 | 20.4 | 19.3 | 16.2 | 20.6 |

Notes: a/ Preliminary estimates.
b/ Forecast.
*Source*: ADB Statistics Division and IMF.

**Figure 1: Africa: Major Economic Indicators, 1996-2000**



ery include buoyant exports boosted by strong international oil prices and progress with macro-economic stabilization, structural adjustment and governance. Twenty countries achieved growth rates of between 3 and 5 percent compared to fourteen in the previous year, while six countries experienced recession. Although the number of countries with negative growth declined to six from eleven, the number with growth rates above 5 percent has been declining since the mid-1990s. As a result, the growth trend for most countries appears to be firmly established at 3.2 percent a year (Table 1 and Figure 1a) — barely above the rate of population growth.

The overall fiscal position for African countries showed a marked improvement in 2000 with budget deficits of 1 percent of GDP compared to an average of 3.5 percent in the previous two years (Table 1 and Figure 1c). This reflects the increase in oil export revenues as well as the improved fiscal discipline of countries undertaking stabilization and structural adjustment programs. Overall inflation rates remained stable at about 13 percent in 2000 (Table 1 and Figure 1b).

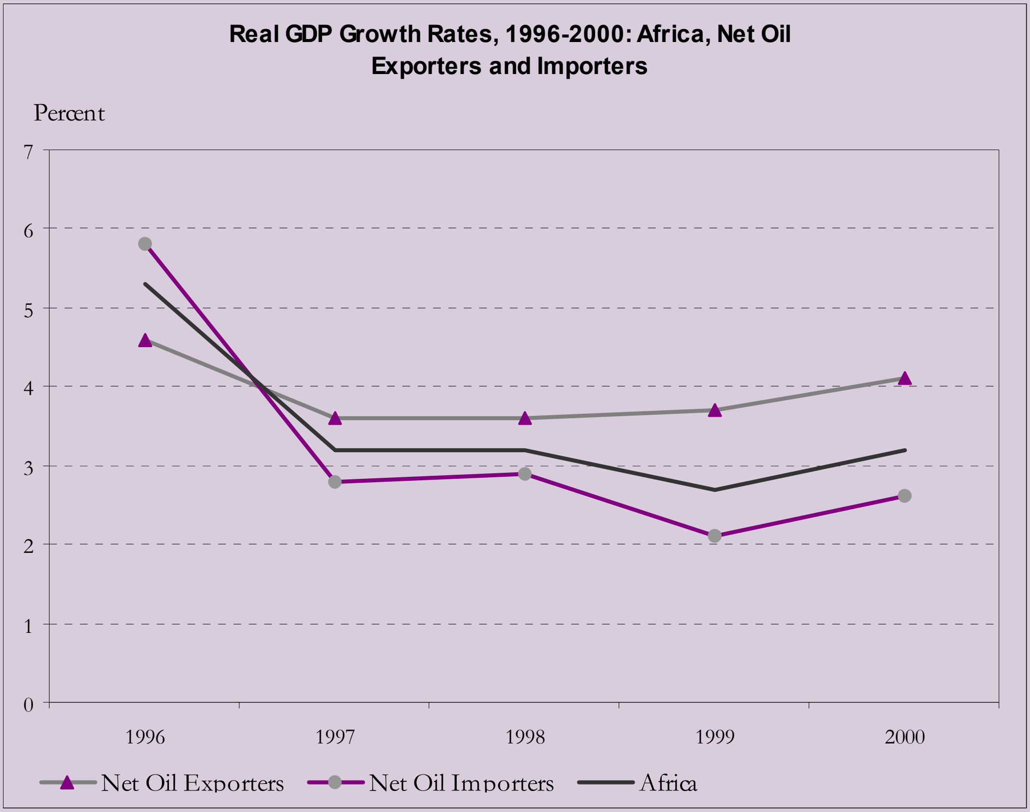
Higher oil revenues also contributed toward significant improvements in external balances with the value of exports reaching $150 billion for the first time. Export volume increased by 7.3 percent—the highest in five years (Table 1 and Figure 1d). With exports volume growing faster than that of imports and with improved terms of trade for major oil exporters, the continent's trade surplus strengthened to $11 billion. Reflecting this improvement and a smaller increase in net services receipts, the current account deficit declined from $18 billion or 3.4 percent of GDP in 1999 to $2 billion or 0.3 percent of GDP in 2000 (Table 1 and Figure 1e).

Sectorally, growth in the industrial and services sectors were the main contributors to output expansion in 2000. The two sectors recorded growth rates of 4.4 percent and 4 percent, respectively, from 3.1 percent and 3.3 percent attained in 1999. The growing importance of tourism is a major factor enhancing the contribution of the services sector in several African economies. Growth in agriculture fell to less than 1 percent, a far cry from 10.6 percent attained in 1996. The main influences on agriculture have been developments in global commodity prices and the adverse weather conditions in countries such as Ethiopia and Morocco. Higher oil prices and constraints on production capacity were the main factors influencing the performance in the energy sector in key economies including Algeria and Nigeria. Sectoral policy developments including privatization of Zambia's state-owned copper company coupled with civil war and conflicts in the main production areas of Angola and the Democratic Republic of Congo impacted adversely on mining output. With the exception of South Africa, weak domestic demand, rising costs of imported raw materials, energy shortages and lack of competitiveness continued to undermine performance of the manufacturing sector.

## Diverse Economic Performance

Following the rebound in oil prices, real GDP growth in the ten major oil exporting countries—Algeria, Angola, Cameroon, Congo Brazzaville, Egypt, Equatorial Guinea, Gabon, Libya, Nigeria and Tunisia— averaged 4.7 percent, well above the continental average of 3.2 percent (Figure 2). African oil importers, however, faced a very different set of international economic pressures, with the result that their GDP growth averaged only 2.7 percent in 2000. Oil importers were hit

**Figure 2**




hard by higher energy costs, weak non-fuel commodity prices, droughts and adverse weather conditions. In some countries erratic macroeconomic policies and poor governance undermined economic performance.

The sharp drop in prices of robusta coffee slowed export growth in Kenya, Uganda, and Tanzania, while in Ghana and Côte d'Ivoire, exports were constrained by weak cocoa prices. Despite this, Tanzania and Uganda maintained their recent impressive growth performance benefiting from an improved policy environment and donor support. Côte d'Ivoire was pushed into recession by the combination of increased energy costs, weak beverage prices, poor domestic policies and political uncertainty.

Amongst the metal producers, Zambia benefited from higher copper prices and the successful, if belated, privatization of the Zambia Consolidated Copper Mines (ZCCM). Botswana maintained its impressive growth with GDP increasing 7 percent in 2000 after a 9 percent rise in 1999. Strong international demand for diamonds increased foreign direct investment and a competitive currency offset the flood damage suffered by the farming sector early in the year. In the Democratic Republic of Congo, higher output of copper and cobalt were not enough to offset the damage to the other sectors of the economy caused by the civil war.

Growth in a number of agricultural countries slowed under the impact of adverse climatic conditions. Agricultural output was adversely affected by drought in Eastern and Northern Africa with Ethiopia, Eritrea, Morocco and Tunisia suffering some of the worst setbacks. In Morocco, although agricultural output contracted by more than 15 percent, growth in the other sectors of the economy, particularly manufacturing and the services sector cushioned the impact on the economy. In the first quarter of 2000, Cyclone Eline caused widespread damage to agriculture and infrastructure, including roads and railways, in parts of Southern Africa, with Mozambique being the worst affected. In Mozambique, growth slowed from the 10 percent average for the three previous years to 7 percent, while inflation escalated sharply and the currency depreciated.

In conflict countries, growth rates averaged 2.8 percent, lagging behind the overall regional growth, although much higher than the average of 1 percent recorded in the previous three years. Nevertheless, per capita income among this group of countries is two and half times below that of the continental average. Output growth in South Africa, the region's largest economy, accelerated from 2 percent in 1999 to 3.1 percent in 2000 reflecting stronger expansion in agriculture and manufacturing and increased earnings from platinum, now the country's chief export, having overtaken gold and diamonds.

Central Africa experienced no growth in 2000 though this represented a significant recovery from a contraction of 4 percent in 1999. The recovery was made possible by a strong performance by oil exporters in the region whose revenues were boosted by the buoyant prices on the global market in 2000, which more than offset the slowdown in conflict countries. The sub-region's current account deficit as a percentage of GDP decreased slightly from 6.2 percent in 1999 to 4.2 percent in 2000 just as its fiscal deficit fell to 2.9 percent of GDP in 2000 from 6.2 percent in 1999. There was also a marginal decline in its external debt from $38.16 billion in 1999 to $34.17 billion (or 128.6 percent of GDP) in 2000. Though money supply remained modest at 8.9 percent in 2000 compared with 8.3 percent in 1999, inflation accelerated to 28.4 percent from 17.6 percent in 1999.

Eastern Africa recorded the second highest growth rate in 2000 at 3.8 percent, down from 4.5 percent in 1999. Growth was constrained by the aftermath of the terrorist attacks that seriously damaged the economies of Kenya and Tanzania in 1998, and the drought that affected the whole region. However, increased tourism earnings, remittances, and net transfers helped to reduce East Africa's current account deficit in 2000 to $3.09 billion or 7 percent of GDP. Though external debt has reduced from $35.73 billion (82.9 percent of GDP) in 1999 to $30.89 billion (70.9 percent of GDP) in 2000, it remains a severe constraint on growth and development and no fewer than 8 of the 11 countries in the sub-region are classified as HIPCs. While money supply fell from 11.7 percent in 1999 to 10.6 percent in 2000, the inflation rate rose slightly to 5.3 percent from 5.2 percent in 1999. Budget deficit remained modest by African standards, averaging 2.5 percent of GDP in 2000 – unchanged from its 1999 position.

In 2000, Northern Africa at 4.1 percent recorded the highest economic growth rate among the five sub-regions of Africa, up from 3.8 percent in 1999. This slightly higher growth reflected higher growth rates across the region (made possible by higher international oil prices), except in Tunisia. Northern Africa's current account balance swung from a deficit of $2.51 billion in 1999 to a surplus of $3.32 billion (1.7 percent of GDP) in 2000, the highest in almost a decade. Its foreign debt fell in line with this improved current account situation, from 70 percent of GDP in 1992 to 40 percent in 2000. With monetary expansion at 11.6 percent in 2000, the inflation rate, which was 22.1 percent in 1996 declined to 5 percent in 2000. The sub-region's budget deficit had stayed below 2 percent of GDP since the mid-1990s and in 2000, the region came close to achieving a balanced budget.

Southern Africa recorded a growth of 2.6 percent in 2000, up slightly from 2.1 percent recorded in 1999. This less than expected growth rate was due to the devastating floods which hit parts of the region early in 2000, and the effects of the deteriorating economic situation in Zimbabwe. The sub-region's current account balance improved from a deficit of $3.32 billion (2.1 percent of GDP) in 1999 to $1.35 billion (0.83 percent of GDP) in 2000. The combined effects of the persistent current accounts deficits and insufficient foreign investments caused the sub-region's external debt to steadily increase between 1994 and 2000, reaching $68.47 billion or 42 percent of GDP. With money supply remaining virtually unchanged at 12 percent in 2000, inflation fell from 30.3 percent in 1999 to 23 percent in 2000. Increased fiscal discipline paid off as budget deficit declined slightly from 2.8 percent in 1999 to 2.6 percent in 2000 in Southern Africa.

Western Africa grew at 3.1 percent in 2000 from 2.8 percent the previous year. Higher growth was spurred by a sharp rebound in Nigeria, the largest economy in the region and the continent's largest energy exporter, as well as by continued strength in smaller economies in the CFA zone. The current account deficit as a percent of GDP fell significantly from 8.32 percent in 1999 to only 1.9 percent in 2000. However, the sub-region's external debt burden remains very high, recording 91 percent of GDP in 2000. Both money supply and inflation continued their downward trend, reaching 16.5 percent and 3.3 percent, respectively in 2000. High oil revenue in Nigeria was able to offset the effects of political instability and high defence spending in the sub-region hence the fiscal balance as a percentage of GDP improved from a deficit of 6.1 percent in 1999 to a surplus of 2.1 percent in 2000.

## External Trade and Finance

A remarkable feature of Africa's balance-of-payments at the beginning of the new millennium was the 25 percent increase in merchandise exports, which reached the $150 billion mark for the first time. The bulk of this export expansion was restricted to the oil exporting nations, reflecting terms-of-trade gains more than volume growth. Export volumes were estimated to have increased by 7.3 percent, while import volumes rose by 4.8 percent. However, the region's terms-of-trade improved by an estimated 15 percent, while some of the major oil exporters, such as Algeria and Nigeria, improved by as much as 50 percent. Consequently, Africa's trade surplus strengthened to $11 billion or 1.3 percent of GDP. Oil producers recorded trade surpluses of more than a quarter of GDP compared to only 7 percent of GDP during the oil crisis of 1998. Also, Africa's current account deficit declined dramatically to only $1.96 billion in 2000 (0.3 percent of GDP), from $18.6 billion (3.4 percent of GDP) in 1999, with major oil exporters and South Africa accounting for the improvements.

In 2000, two major policy initiatives that are likely to affect Africa's export prospects came into effect. First, the European Union and the African, Caribbean and Pacific States Group (ACP) of countries reached agreement on a successor arrangement to the Lomé Convention. This agreement sets out a framework for a new 20-year partnership between the EU and the ACP Group. Similarly, the Africa Growth Opportunity Act, which was designed to improve trade and investment opportunities between the US and selected low-income African countries, was approved. These initiatives are important, as market access needs to improve for exports of African countries. It is estimated that since the 1970s Africa's agricultural exports have lost some $70 billion in market share due to inefficiency and protectionism by its major trading partners. Agricultural subsidies in the developed countries cost some $300 billion a year or about 100 times current aid levels to Africa.

The region's net reserves increased by some $14 billion in 2000. Net external financing to the region declined from $27.3 billion in 1999 to $26.3 billion in 2000. While capital transfers increased from $5.4 billion to $8.3 billion (53 percent) between 1999 and 2000, foreign direct investment declined marginally by 5 percent to $9.3 billion.

The continent's debt stock also declined marginally from $337.2 billion in 1999 to $334.3 billion in 2000. This was made up of $38.9 billion of short-term obligations and $295.3 billion long-term. This maturity structure is explained by the preponderance of official borrowing - some 70 percent of Africa's debt is owed to official creditors. Only 12 percent was owed to banks and financial institutions in 2000 and the balance of 18 percent to other private creditors. With GDP increasing while the debt stock declined, Africa's total debt to GDP ratio fell from 61.4 percent in 1999 to 58 percent in 2000. Similarly, improvement in the region's export meant that the ratio of foreign debt to exports of goods and services decreased significantly from 225.3 percent to 182.6 percent over the same period. Despite this, in many countries the present value of debt as a proportion of exports of goods and services exceeds 200 percent. Indeed, large foreign debt and high interest rates have combined with adverse terms of trade to make debt service payments simply unmanageable for many countries, which is why 31 African states are now classified as Heavily Indebted Poor Countries.

After an impressive upswing in 1999, African Stock markets declined in the year 2000. Market capitalization declined somewhat to $240 billion from $249 billion recorded in 1999, though this figure was distorted somewhat by the strength of the dollar. By the end of December 2000, only the Tunisian and Nigerian Stock Exchanges kept ahead of the surging dollar. Tunisia was up 50 percent and Nigeria 30 percent, while in contrast, the capitalization of the Ghanaian market, rose 15 percent in Cedi terms, but fell 40 percent in dollar terms. The Johannesburg Stock Exchange (JSE), which accounts for 89 percent of regional market capitalization, saw the value of its market plunge from $245 billion in January 2000 to $213 billion in December 2000. The decline was against a background of relatively strong economic fundamentals, reflecting the strength of the dollar along with concerns over regional stability, emanating from the Zimbabwean crisis.

## Macroeconomic Policy Developments

Macroeconomic strategy in most African countries emphasizes restrictive monetary and fiscal policies to achieve internal and external balances as well as structural, institutional and governance reforms in order to provide a conducive environment for private sector-led growth. In 2000, Africa's overall budget deficit declined to one percent of GDP from an average of 3.5 percent in the previous two years. Higher oil revenues in the major oil-exporting countries, as well as continued fiscal restraint in some of the smaller economies drove this improvement.

Broad money supply growth slowed to 13.4 percent in 2000 from 17.9 percent in 1999 and 18.7 percent in 1998. More than thirty countries recorded money supply growth below the regional average. Although the region's average inflation rate of 12.7 percent was only marginally higher than in 1999, it was almost four times lower than the peak reached in 1994 as restrictive fiscal and monetary measures outweighed higher energy costs. Consumer prices remained subdued with forty countries registering single digit inflation rates with the median inflation rate for the 53 African countries being less than 5 percent.

Almost all African currencies depreciated to some extent during 2000, though this was partly explained by the strength of the US dollar in global financial markets. In Egypt, for example, the exchange rate was allowed to depreciate gradually, declining an estimated 5.1 percent over the year. The Nigerian naira, on the other hand, experienced a sharp depreciation in 2000 despite higher oil export earnings, higher foreign remittances, and a relatively lower inflation rate. This was attributed to large net outflow of short-term capital to finance imports. The gap between official exchange rate and the parallel market rate remained high at about 10 to 15 percent.

The South African rand also experienced increased volatility, losing almost 20 percent of its value against the US dollar due to the dollars' strength and the contagion effect of the deteriorating political situation in Zimbabwe. The CFA franc, which depreciated against the dollar by 14 percent in 1999, weakened further as a direct result of the slide in the Euro to which the Franc Zone currency is linked through its peg to the French franc. The European Central Bank raised interest rates partly to shore up the Euro, which hit record lows against the dollar.

## Sectoral Developments

Agriculture dominates most African economies (South Africa and Mauritius being the major exceptions), employing about two-thirds of the region's total labor force and accounting for about one-third of GDP and one half of exports. Agriculture's value-added in Africa's GDP was 17 percent in 2000, compared with 50 percent for the services sector and 33 percent for the industrial sector. Agriculture's low value-added reflects the inefficient nature of agricultural production, with a high dependence on rain-fed farming and limited use of fertilizers and modern inputs. In 2000, agriculture grew by a mere 0.6 percent, down from 1.1 percent recorded in 1999. But the performance of agriculture is central to food security and poverty reduction since the majority of the region's poor live in rural areas. During the year, food security in the region was seriously threatened, as many countries, particularly in Eastern Africa, were unable to meet production targets. The number of people facing food shortages is estimated to have risen from 19 million in 1999 to 28 million in 2000.

With two thirds of agricultural export earnings derived from only six commodities—cocoa, coffee, cotton, sugar, tobacco and tea—African economies are largely dependent on a narrow range of export crops. Coffee and cocoa accounted for over half of total export earnings in the mid-1990s. While some agricultural exports (cotton, rubber and tea) enjoyed significant price recoveries in 2000, others (coffee, cocoa and tobacco) experienced further major declines. The commodity that suffered most from global price declines in recent years is cocoa whose price fell to a 30-year low in the first quarter of 2000 when the prices were a third of their early 1999 levels. With an output of 1.25 million tonnes or 42.5 percent of global production, Côte d'Ivoire was severely affected—followed by Ghana, which produces 410,000 tonnes.

Growth in the industrial sectors averaged 4.4 percent in 2000, up from 3.1 percent in 1999. One of the most significant problems facing African economies remains the difficulty of increasing the share of manufacturing output in overall growth. Estimates indicate that growth in manufacturing value-added (MVA) slowed from 5.7 percent in 1998 to 4.1 percent in 1999 and 2.7 percent in 2000. Excluding South Africa, MVA growth is estimated at only 1.7 percent in 2000, while sub-Saharan Africa's share of global MVA was only 0.4 percent— unchanged for four years—and compared to 23.6 percent in other developing economies. Africa's share of manufactured exports, excluding South Africa, was 0.2 percent in 1995 and is reckoned not to have changed since then.

Apart from the slow growth of manufacturing activity and its insignificant share of total exports, the distribution of manufacturing activity in the region is extremely skewed. In sub-Saharan Africa, South Africa accounts for 54.5 percent of MVA with the other significant players being Côte d'Ivoire with 4.7 percent, Cameroon (4.6 percent), Zimbabwe (3.8), Nigeria (3.7), Kenya (2.4), Mauritius (1.7) and Ghana with 1.6 percent.

Mining continues to be a significant source of foreign exchange in many African countries and indeed drives economic performance in mineral-dependent states like Botswana, Namibia, Zambia and the DRC. It has long been accepted that Africa's mining output falls well short of its real potential, reflecting a scarcity of capital. Thus, while many African countries are well endowed with mineral deposits, their significance in the world market is diminishing. For example, in 1976, Africa accounted for 61 percent of world gold output but by 2000 its share had slumped to 23 percent—largely reflecting the decline in South African production, whose share of world output has fallen to only 18.5 percent. Ghana, Africa's second largest producer, accounts for just 3 percent of world output while Zimbabwe's market share is only one percent.

In 2000, developments in global prices for metals varied considerably with price of gold stabilizing while the prices of other metals recovered. Gold-dependent countries—Ghana, Mali, Zimbabwe, South Africa and, increasingly, Tanzania — all suffered as a result. Although many African countries are significantly endowed with a limited range of mineral ores, they usually lack the other inputs required for the development of a strong and broadly-based metals industry. Accordingly, integration is essential for the development of an industrial base that will attract mining investment. In the absence of such industrial integration the fortunes of mining-dependent economies will continue to depend on the vagaries of the unstable global metal markets.

Crude oil prices increased from an average of $18 per barrel in 1999 to average $28.5 per barrel in 2000, with divergent impacts on African economies – net oil exporters benefiting against net oil importers. Apart from output increases in oil-producers, a number of credible exploratory activities in West and Central Africa, particularly offshore, suggest that more discoveries of oil and gas are likely in the near future. Substantial new discoveries of oil have been made in Angola, where an estimated 1.35 billion barrels of oil were discovered in 1999—the third highest in the world after Iran and Saudi Arabia. Although crude oil remains the dominant source of revenue in the energy sector, the energy resources of Africa are immense; they include natural gas, coal, nuclear, tar sand, hydro-electricity, geo-thermal, bio-mass, solar, wind and other renewable energy resources.

In a number of African countries, services are the fastest growing sector of the economy. In the early 1990s, financial services, transport and distribution were the leaders but more recently, tourism and telecommunications have attracted increased interest and investment, especially in telecommunications, due to privatization. In 2000, the sector grew by 4 percent compared to 3.3 percent the previous year.

In North Africa tourism plays a vital role not only in Egypt, which has a long tradition of attracting tourists to its pyramids and other ancient Egyptian monuments, but also in Morocco and Tunisia. These three countries are the largest markets for tourism in North Africa, accounting for more than 99 percent of the region's tourism revenues. East Africa is also a major tourist destination, with the industry leaders being Kenya, Uganda, Tanzania, Mauritius, and Seychelles. Kenya, Tanzania, Uganda and Mauritius, account for an overwhelming share of the sub-region's tourism revenues. Total tourism receipts from these countries increased steadily from $1.2 billion in 1995 to $1.6 billion in 2000, though Kenya suffered a setback in the wake of the terrorist bombings that killed and maimed scores of people in 1998.

While tourism continues to dominate the services sub-sector, there is significant expansion of the Information and Communications Technology (ICT) in a number of countries – though dominated by South Africa. To boost productivity and increase competitiveness, African economies must develop and exploit the knowledge revolution. Its ability to do this depends, however, on increased investments in physical infrastructure and skills and technology development. Also, apart from capacity and institution building programs, Africa must forge strategic alliances with foreign partners as well as formulate a supportive, robust and appropriate public policy environment for e-business.

## The Medium-Term Outlook

In 2001, the African economy is forecast to grow by 4.1 percent, while real per capita income is to increase by 1.8 percent. This forecast is conditioned on stronger expansion in South Africa, steady growth in the other larger economies and the continued strength of some of the continent's smaller economies. Even in conflict countries, growth is expected to accelerate significantly from 2.8 percent in 2000 to 4.8 percent in 2001 following the end of the war between Ethiopia and Eritrea and improved peace prospects in some other conflict areas, particularly the Democratic Republic of Congo. However, the conflict situations in Guinea, Liberia and Burundi remain uncertain and may undermine this optimistic outlook somewhat.

Furthermore, Africa's growth will continue to be shaped by developments in commodity prices and export market performance. Continued recovery in prices of non-fuel commodities, especially industrial metals, is expected in 2001, reflecting stronger growth in the EU, though this will be offset to some extent by a weaker US economy, and ongoing sluggishness in Japan. The post-Lomé Convention Partnership Agreement between the EU and the African, Caribbean and Pacific Group of States (ACP), and improved African access to the US market through the Africa Growth and Opportunity Act (AGOA), should also boost regional export expansion. Higher growth rates in Africa in the medium to long term also depend on the continued commitment of governments to economic reform programs. Inconsistent and delayed responses to reform initiatives put pressure on governments to adopt more short-termist policies, especially when economic and political reforms are undertaken in tandem.

Despite the brighter economic outlook for the continent, the fact remains that the expected recovery still falls far short of what is needed to improve the living conditions of millions of Africans and sustain the region's structural transformation. This will require increased domestic investment; the promotion of broad-based growth through mobilizing domestic and foreign resources for development; and tackling issues related to human development, particularly HIV/AIDS.

## Fostering Good Governance in Africa

Governance is now one of the cornerstones of economic development. Good governance, in its political, social, and economic dimensions, underpins sustainable human development and the reduction of poverty in that it defines the processes and structures that guide political and socio-economic relationships. Governance can be seen as the exercise of economic, political and administrative authority to manage a country's affairs at all levels. It comprises the mechanisms, processes and institutions through which citizens and groups articulate their interests, exercise their legal rights, meet their obligations and mediate their differences. Good governance is, among other things, participatory, transparent and accountable. It is also effective and equitable. And it promotes the rule of law. Good governance ensures that political, social and economic priorities are based on broad consensus in society and that the voices of the poorest and the most vulnerable are heard in decision-making over the allocation of development resources. Poverty reduction programs are very often undermined by conflicts, a lack of public accountability, corruption, and the exclusion of beneficiaries in the program processes.

Several factors have combined in recent years to give new impetus to the issue of governance in the development debate. Pervasive corruption for example weakens government's ability to function effectively and severely detracts from the equity goal in the provision of public services. Another driving force has been the rise of pro-democracy movements on the continent demanding good governance and more responsive forms of government, as has the rising disquiet over the cost of corruption in terms of both domestic and external resources. Similarly the unparalleled increase in globalization and its even stronger imperatives for sound domestic policy environment and economic management have been the motivating factors behind the quest for good governance. The challenge for all societies is to create a system of governance that promotes, supports and sustains human development - especially for the poorest and most marginal.

## Building the Political Context for Development

The issues of politics, conflict and corruption are closely interrelated with each other as well as with the issues of development and poverty reduction. While good politics foster economic development and social cohesion, and reduce corruption, bad politics breed corruption, retard socio-economic development and may lead to civil conflicts and wars.

Good politics can be looked into with reference to three axioms. The first axiom is ***citizens' influence and oversight***, which relates to the means available for individual citizens to participate in the political process and to hold their governors accountable for their decisions and actions. The second axiom is ***responsive and responsible leadership***, which refers to the attitudes of political leaders toward their role as public trustees and their adherence to the rule of law and their readiness to share information with citizens. The third axiom is ***social reciprocities***, which refer to the degree to which citizens or groups of citizens treat each other in an equal fashion, and how far such groups demonstrate tolerance of each other in the pursuit of politics. It also speaks of how far the different groups in a country are capable of transcending the boundaries of religion, kinship, ethnicity, and race.

These three axioms are interlinked. If citizens have no influence and oversight and the political leadership is irresponsible and not responsive to the voice of the people, the environment will be ripe for political instability, underdevelopment, corruption and socio-economic decay. Non-adherence to the axiom of social reciprocities – where social groups and their leaders are incapable of transcending the boundaries of religion, kinship, ethnicity, or race – is a recipe for violent conflicts and civil war. With this framework in the background, the Report examines Africa's record with reference to the political environment, the prevalence of corruption and the incidence of conflicts. The Report also explores the measures that need to be taken in order to establish participatory democracy in Africa with the aim of building the political foundation of socio-economic development, reducing corruption and promoting social cohesion.

Since independence, African countries have experienced widely differing forms of political governance, ranging from extreme totalitarianism to liberal democracy. The attributes of the political leadership and the state with respect to the overall economic management, rule of law, and respect for private property have been influenced significantly by the prevailing political governance regimes. Box 1 provides some insights on the question of political leadership in Africa and its evolving nature in an era where economic reforms and democracy are becoming the norm.

Civil wars and armed conflicts have figured prominently in the political history of Africa. Starting with the early days of independence when the accent was on nation building and socio-economic transformation, Africa experienced various forms of institutions and strategies. While an enduring stability emerged in some countries a good many encountered civil strife and conflicts generated by dissatisfactions with the economic, social and political arrangements. According to the Organization of African Unity (OAU), 26 African conflicts took place from the establishment of the organization in 1963 to the end of 1998. Some of the world's longest civil wars were in Africa (Ethiopia, Mozambique and Sudan) and some older civil wars are still raging. All in all, 474 million Africans, representing 61 per cent of the population of the continent, were affected by these conflicts.

## Box 1: Political Leadership and Economic Reforms in Africa

### Leadership Transitions, Risk and Behavior

Political economy offers a theory of micro-level behavior in which an overly-cautious or corrupt leader attempts to maximize his utility under conditions of personal and political uncertainty. A leader's intertemporal choices include future events with a present value, which one can calculate by using a political discount rate. That rate of discount rises with risk and uncertainty. When an outcome is doubtful over time, it makes sense to mark down its present value.

The probability of leaving office and the likely mode of exit are two factors that plausibly affect African leaders' intertemporal risk estimates, which, in turn, may influence the way they exercise power. Table 1 summarizes how independent Africa's 180 leadership successions took place. By far the most common means for African leaders to lose power is through a coup d'état or similar extra-constitutional event. Between 1963 and 2000 over 200 regimes ended with a coup, civil war or invasion. The large proportion of coups can be construed as a sign that leaders in Africa typically employ high political discount rates. High political discount rates are also a possible explanation for the extensive and destructive political corruption seen in Africa.

At the same time, Africa is famous for leaders with long tenure. Fourteen present national heads in the region have been in office for between ten and 20 years; nine have served more than 20 years. The mean tenure for all former African leaders is 7.2 years, and about twice that for leaders who died in office or retired. For comparison, European national leaders served an average of 3.2 years over the past four decades, with Finland having the shortest average duration and Luxembourg the longest. At first, the relative lack of turnover would seem to contradict the hypothesis that the political environment for leaders is unstable or insecure. Yet, another interpretation is plausible. In the field of finance, risk is associated with volatility. The same may be true in politics. For the individual ruler who wants to weigh his prospects of retaining power, the average term of office may be a less meaningful statistic than is the variation around the mean. As an indication of how much volatility exists, three recently independent countries have had no leadership transitions. Another 11 countries have had just one transition since independence. At the far end of the spectrum, Nigeria has had 11 transitions and Benin has had 12.

The rational leader also needs to anticipate what may happen to him were he to lose power. Of the 101 past leaders who left office due to a coup or similar unauthorized event, roughly two-thirds were killed, imprisoned, or banished to a foreign country. Twenty-seven former rulers died violently, counting five whose deaths appear to have been independent of a coup or coup attempt. The remaining 22 leaders in this category clearly perished as a direct result of coups. Of Africa's overthrown leaders who were not executed or assassinated, 37 were detained and held in jail or placed under house arrest. Twenty-nine other ex-leaders were forced into exile, at least temporarily. That figure does not include nine ex-leaders who experienced periods of both imprisonment and banishment. Some rulers may look for reassurance in the region's declining rate of

**Table 1: How Leaders Leave Office in Africa, 1960-1999**

| | Number of Incidents | | | | | |
|---|---|---|---|---|---|---|
| | 1960-69 | 1970-79 | 1980-89 | 1990-99 | Total | Mean Time in Office Years |
| Overthrown in coup, war or invasion | 27 | 30 | 22 | 22 | 101 | 5.7 |
| Die of natural or accidental causes | 2 | 3 | 4 | 3 | 12 | 11.7 |
| Assassination (not part of coup) | 1 | 0 | 1 | 3 | 5 | 7.8 |
| Retire | 1 | 2 | 5 | 9 | 17 | 11.7 |
| Lose election | 0 | 0 | 1 | 12 | 13 | 14.8 |
| Other (interim or caretaker regime, impeachment) | 6 | 8 | 4 | 14 | 32 | 1.2 |
| All regime transitions | 37 | 43 | 37 | 63 | 180 | 7.2 |

**Box 1: (Continued)**

coups. The rate of military takeovers has dropped steadily, falling from 0.087 per country year in the 1960s to 0.046 per country year in the 1990s. So, the region-wide probability of being overthrown is currently about half what it was in earlier years.

There is little doubt, therefore, that holding high office in Africa poses acute risks. To what extent do those risks affect leaders' behavior, specifically their behavior in the areas of economic reform and corruption? That question is difficult to answer fully without detailed case studies of the individuals' involved, but aggregate data may give us clues about how these leaders conduct themselves. Low-risk environments would tend to produce more reform-minded leaders. Table 2 provides some evidence that such may be the case in Africa. A correlation exists between the hazards of leadership and the degree of economic freedom. Leaders in the so-called "mostly free" countries were the least likely to be overthrown, killed, arrested, or exiled. Leaders in the mostly unfree and repressed countries, by contrast, experienced a greater number of negative outcomes. Correlation does not prove causation, especially in making inferences about micro-level behavior based on macro-level data, but the results are consistent with political economy theory. Low political risk and economic reform seem to go together in Africa. The predicament facing any individual national leader is that the payoffs to most economic reforms lie in the future, but he also has to hold on to power now. An insecure power base is likely to encourage either reckless gambling for immediate returns or highly cautious strategies to preserve political capital; it is unlikely to promote measured actions to obtain long-range returns.

**Democratization and Improved Leadership**

Better leadership is not the cure-all for Africa's lack of development, but it would be an important step in the right direction. Political economy theory also suggests that one solution to poor leadership is to make the political environment less hazardous. A safer environment would reduce the incentives to engage in political misbehavior and, in principle, encourage responsible and forward-looking activity. In this context, Africa's recent moves toward democracy and competitive elections are reasons for hope. Since 1982, 13 incumbents have been turned out of office by voters – accounting for about one-sixth of the leadership transitions in the l990s. The threat of losing an election also may account for the increasing rate of leader retirements – nine in the l990s versus only eight in the previous three decades.

Democratization appears to be altering the outcomes of the many coups that still occur. In the past, the new heads of military juntas often declared themselves permanent leaders (sometimes after doffing their uniforms and becoming "civilians"). Now, it is becoming the norm for coup leaders quickly to organize internationally acceptable elections. More importantly, the people of Côte d'Ivoire have demonstrated the consequences of failing to honor the election results afterwards. African elections have not yet produced marked beneficial effects. Still, the rise of orderly political competition does offer hope for encouraging African leaders to act positively and redress decades of oppression and economic decline.

**Table 2: Hazards of Leadership, by Economic Policy Category**

| Policy category (1995-2000) | Leaders overthrown | Leaders Killed | Leaders Arrested | Leaders Exiled |
|---|---|---|---|---|
| Mostly free countries | 1.0 | 0.2 | 0.2 | 0.5 |
| Mostly unfree countries | 2.5 | 0.6 | 1.0 | 0.7 |
| Repressed countries | 1.5 | 0.5 | 0.6 | 0.6 |

Note: The economic policy categories are based on the Heritage Foundation economic freedom ranking for 1995-2000.
*Source:* Adapted from Goldsmith (2000).

No region was spared the agony of the sufferings caused. The factors that trigger civil wars are complex, but the root causes are often found in the inability to respect social reciprocities: political inequality, inter-group intolerance, and the lack of inclusiveness in associational membership.

While it is difficult to provide a complete account of the negative economic impact of civil strife and conflict on economic performance some obvious effects are generally known. These include the destruction of physical and human capital, reduction of savings, diversion of portfolios from domestic investment to capital flight, disruption of economic transactions, and distortion of government expenditure from the provision of public services to military expenditure.

The onset of conflict entails that it takes on a life of its own so that resolving it becomes a complex challenge. Conflict resolution, peace-building and reconstruction require committed assistance from neighboring countries and the international community. The United Nations used to be the primary institution in peacekeeping and peace-building, but lately the Organization of African Unity, the Economic Community of West African States (ECOWAS) and the Southern African Development Community (SADC) have taken up responsibilities for dealing with conflicts in Africa. Collaboration between the international development community and regional and sub-regional organizations in Africa is vital, not only to establish peace but also in rebuilding efforts. Reconstruction requires a comprehensive approach, ongoing dialogue between the stakeholders, shared goals and objectives to guide assistance, considerable resources, and a long-term commitment.

Socio-economic development cannot take place without stable political and civil conditions and institutions that would establish social cohesion, secure rights of private property, ensure personal liberty, enforce contracts, and provide responsive, transparent and accountable governments. While there is no dispute that the existence of good governance and societal peace are a sine qua non for the pursuit of sustainable socio-economic development, one cannot speak of a single ideal model of political governance that African states should aspire to emulate. Even among developed liberal democracies around the world there are wide variations in approach and in forms of governance.

Despite the differences in approach, effective political governance tends to have some fundamental characteristics, which African countries must endeavour to establish if they are to build good public administrations. These characteristics include:

*Basic Political Order*: where internal conflicts and war have undermined public authority in almost all sphere of life. In the Great Lakes Region, the Horn of Africa, the Mano River Basin, and the Niger Basin countries have been rocked by internal conflicts and civil strife that make it difficult for people to engage in any productive activities to improve their lives. In these war-torn countries, the settlement of conflicts, the establishment of peace and the creation of basic political order are necessary conditions for good governance as a prelude to fighting poverty.

*Political Legitimacy*: through periodic free and fair elections during which results are acceptable to both winners and losers. As Africa enters the new millennium, there seems to be renewed hope that, with improved governance, economic growth can once more be rekindled and poverty reduced. The wave of multi-party elections that have been held across the continent are given as indicators of growing democracy and good governance. The smooth changes of government through democratic elections in Senegal, Ghana and Benin are cited as testimonies to maturing democracies and institutionalizing good governance. When constitutional, legislative and electoral rules make it hard to change laws and procedures arbitrarily, then governmental legitimacy becomes more institutionalized to ensure that legal and bureaucratic systems function effectively, efficiently and relatively honestly. Such institutionalized legitimacy is good for business, job creation, income generation and hence the fight against poverty.

*The Rule of Law*: as an aspect of government without privileged regard to any individual on the basis of tribe, region of origin, race, sex, income or any other ground for discrimination. A legitimate and democratic system of government needs to be based on the rule of law. This means that, on the basis of rules and regulations laid down by the legislature, implemented by the executive arm of government and adjudicated by the judiciary (in the event of a dispute), individuals will seek to maximize their interests as citizens endowed with rights and obligations by the state. While accepting basic human rights as inalienable, the rule of law assumes every citizen will assimilate the principles and ideals of citizenship as the basis of exercising his or her rights and claiming the same from the state.

*Popular Participation*: in policymaking and decisions on resources allocation from the grassroots to the national level. Democracy is premised on the fact that the ruled (the people) participate in a process of freely electing their rulers (the governors). Participation, however, goes much further beyond elections. It must also embrace daily acts of decision making, policy formulation and resource allocation from local level institutions of government to the national level. Democratic participation, or popular participation, also assumes that formal institutions of government make policies and allocate resources on the basis of interests, preferences, ideas and biases from multiple sources in *civil society.*

## Corruption and Development

Corruption is closely linked to the absence of citizens' influence and oversight and to unresponsive and irresponsible political leadership. Corruption becomes prevalent when the people are not empowered to participate in the political process and have no means to hold political leaders and their administrations accountable for their decisions and actions. Corruption takes hold in society when political leaders do not honor their role as public trustees, do not adhere to the rule of law, and are not ready to share information with citizens. In these environments, failures in economic policy create rent-seeking opportunities, and the weaknesses in public administration provide public servants the opportunities to engage in corrupt practices. All these factors, in addition to the inadequacy of legislative and judicial oversight, provide a nurturing environment for corruption.

A measure of the extent to which corruption is prevalent in African countries can be obtained from the Corruption Index of Transparency International (CITI). The CITI measures the perception of corruption as seen by business people, risk analysts and the general public. The CITI ranges between ten (highly clean) and zero (highly corrupt). The classification of country CITI scores by regions reveals that the degree of corruption in Africa is similar to that of Eastern Europe. The 22 African countries covered by the

CITI scored an average of 3.4 points— the same score for the 21 East European countries covered by the CITI (see Table 2). The CITI averages for the other regions are Latin America 3.9, Asia 4.5, Western Europe 7.8 and the US and Canada 8.5. In a nutshell, although the degree of corruption in Africa must not be underplayed, the comparison with other developing countries in Eastern Europe and Latin America countries supports the argument that the extent of corruption in Africa is often overstated. In this respect, it might be remarked that the average score for Africa fairs better in comparison with the scores of individual countries for instance, Mexico (3.3), Thailand (3.2), China (3.1), Romania (2.9), India (2.8), Russia (2.1), and Indonesia (1.7).

The distribution of incidence shown by the CITI suggests that corruption thrives in emerging and transitional economies where the political system is immature. Corruption is also associated with too many controls and too much political and administrative discretion and poor low real wages. Corruption is bad for both. It hinders proper resource management, undermines efforts to enhance growth and reduce poverty, and obstructs sound and sustainable private sector growth. Corruption has a crippling effect on development through undermining the rule of law and weakening the foundations of national institutions on which economic development depends. The negative impact of corruption falls mostly on the poor who are hardest hit when there is an economic decline.

Widespread corruption also reinforces existing economic and social inequalities, and it undermines the credibility of government and public institutions. Perceptions of widespread corruption reduce donor assistance, as public support in donor countries is undermined. Corruption in aid programs reduces their benefits to recipients. Where programs are funded through loans, the burden of external debt is increased without commensurate social returns. Likewise, foreign direct investment is reduced as corruption undermines confidence of private foreign investors.

Unless comprehensive and systematic actions are taken to combat corruption, the vicious circle of rising poverty, poor governance and corruption is likely to continue unabated. Corruption transcends national borders and must be combated both at the national and global levels. Action is needed at both levels to successfully address the corruption problem. Action is also needed in the political, legal and economic areas. The first step is to secure a strong commitment at the highest political level, as it is often the most difficult hurdle. When corruption is widespread and involves the political establishment, fighting corruption will involve political risks. To sustain a new culture that is corruption-free, the people must be empowered by making leaders accountable to the people and their stakeholders, providing access to information and providing the people with the education needed to understand issues and make informed decisions. A strong and independent press will be indispensable to this effort as will the supremacy of the rule of law.

Prevention efforts must focus on the holders of offices of trust and also those who offer bribes. A code of conduct for private business should spell out what is a corrupt practice and what is legitimate business promotion. Similarly, a public code of ethics should be developed to address the issue of corruption. A good prevention strategy requires strong enforcement to provide effective deterrence. Laws against corrupt behavior at all levels must be enforced without favor. Laws and regulations should be reviewed to remove any ambiguities that create incentives for corrupt behavior. In addition, the judiciary

**Table 2: Corruption Perceptions in Africa Compared to Other Regions (2000)**

| Country Rank | Country | 2000 CPI Score | Surveys Used | Standard Deviation | High-Low Range |
|---|---|---|---|---|---|
| **African Countries** | | | | | |
| 1 | Botswana | **6** | 4 | 1.6 | 4.3 - 8.2 |
| 2 | Namibia | **5.4** | 4 | 0.8 | 4.3 - 6.1 |
| 3 | Tunisia | **5.2** | 4 | 1.5 | 3.8 - 7.1 |
| 4 | South Africa | **5** | 10 | 0.9 | 3.8 - 6.6 |
| 5 | Mauritius | **4.7** | 5 | 0.8 | 3.9 - 5.6 |
| 6 | Morocco | **4.7** | 4 | 0.7 | 4.2 - 5.6 |
| 7 | Malawi | **4.1** | 4 | 0.4 | 3.8 - 4.8 |
| 8 | Ghana | **3.5** | 4 | 0.9 | 2.5 - 4.7 |
| 9 | Senegal | **3.5** | 3 | 0.8 | 2.8 - 4.3 |
| 10 | Zambia | **3.4** | 4 | 1.4 | 2.1 - 5.1 |
| 11 | Ethiopia | **3.2** | 3 | 0.8 | 2.5 - 3.9 |
| 12 | Egypt | **3.1** | 7 | 0.7 | 2.3 - 4.1 |
| 13 | Burkina Faso | **3** | 3 | 1 | 2.5 - 4.4 |
| 14 | Zimbabwe | **3** | 7 | 1.5 | 0.6 - 4.9 |
| 15 | Côte-d'Ivoire | **2.7** | 4 | 0.8 | 2.1 - 3.6 |
| 16 | Tanzania | **2.5** | 4 | 0.6 | 2.1 - 3.5 |
| 17 | Uganda | **2.3** | 4 | 0.6 | 2.1 - 3.5 |
| 18 | Mozambique | **2.2** | 3 | 0.2 | 2.4 - 2.7 |
| 19 | Kenya | **2.1** | 4 | 0.3 | 2.1 - 2.7 |
| 20 | Cameroon | **2** | 4 | 0.6 | 1.6 - 3.0 |
| 21 | Angola | **1.7** | 3 | 0.4 | 1.6 - 2.5 |
| 22 | Nigeria | **1.2** | 4 | 0.6 | 0.6 - 2.1 |
| | **Average** | **3.4** | **4.4** | **0.8** | **2.6 - 3.5** |
| **Other Regions** | **Number of Countries** | | **Averages** | | |
| Eastern Europe | 21 | **3.4** | 4.1 | 0.7 | 2.5 - 4.7 |
| Latin America | 11 | **3.9** | 3.8 | 0.5 | 3.0 - 5.3 |
| Asia | 12 | **4.5** | 3.8 | 0.5 | 2.8 - 5.8 |
| Western Europe | 18 | **7.8** | 4.2 | 0.7 | 6.3 - 8.9 |
| North America | 2 | **8.5** | 4.0 | 0.6 | 7.2 -9.6 |

Notes: 2000 CPI Score: Relates to perceptions of the degree of corruption as seen by business people, risk analyst and the general public and ranges between 10 (highly clean) and 0 (highly corrupt). **Survey Used**: Refers to the number of surveys that assessed a country's performance. 16 survey used and at least 3 surveys were required for a country to be try to be included in the CPI. **Standard Deviation:** Indicates differences in the values of the sources: the greater the Standard deviation, the greater the differences of perceptions of a countries among the sources. **High-Low Range**: Provides the highest and lowest values of the sources.
*Source:* Compiled by the Research Division from Transparency International, Corruption Perceptions Index 2000.

must be built up to ensure the probity and effectiveness of these agents.

While corruption is first and foremost a national problem, its international dimension has taken on increasing prominence as the world becomes more and more globalized. According to one estimate, African leaders not long ago had $20 billion on deposit in Swiss banks alone. Businesses in many parts of the world are known to pay their way for winning contracts abroad. Also in the international arms trade, probably the world's dirtiest legitimate business, one estimate reckons that roughly $2.5 billion a year is paid in bribes, nearly a tenth of turnover. Clearly, there is a need for a global approach in the fight against corruption. The Basle Committee on Banking Regulations and Supervisory Practices, for instance, considers that banking supervisors have an obligation to encourage ethical standards of professional conduct among banks and other institutions which are often used as intermediaries for the transfer off graft monies by money launderers. Indeed, all countries participating in global commerce should enforce anti-bribery laws abroad. Anti-corruption measures should apply equally to rich and poor countries, and should target all those who are directly guilty of corrupt behavior, as well as those who facilitate corruption and embezzlement.

## Promoting Economic and Corporate Governance

Good political governance is not only a worthy goal in itself but is also essential for providing the foundation for good economic governance which is central to the process of economic growth and development. Economic outcomes such as economic growth, employment generation and poverty reduction all hinge crucially on economic governance. The basic elements of good economic governance are outlined in Box 2. As can be observed, the starting point in addressing issues pertaining to economic management is to define the development vision of the state, which delineates such strategic choices as the balance between the state and market and the adoption of an inward-looking or outward-looking development approach. The vision should contain clear short- and long-term policy targets and the policy instruments to pursue them. It should also contain criteria for choosing between policy instruments in accordance with their probability of effect, whether they act directly on the problem or not, and their resource cost and flexibility.

A state's development vision has to take account of the likely public reaction to the policies of the state (the gainers and losers), and the width and the depth of their impact on societal groups. Within the framework of the vision, policy-making would have to involve prior consultation with those likely to be affected by the policies. There must be an extensive dialogue with private interests and the government should have adequate knowledge of the interests of particular societal groups.

In this vein, an increasing number of African countries now recognize that the road to effective development lies not only in the pursuit of short-term economic reforms, but also in the adoption of a long-term vision based on clear strategic choices. Indeed, efforts led by countries such as South Africa, Nigeria, Senegal and Tanzania—which launched the "Millennium Africa Renaissance Program"—show a firm commitment to the sustainable development of the continent. While the specific contours of a long-term visionary plan may differ according to country circumstances, the lessons drawn from past experience and from the implementation of economic

**Box 2: Elements of Economic Governance**

Good political governance is not only a worthy goal in itself but is also essential for providing the foundation for good economic governance which is central to the process of economic growth and development. Economic outcomes such as economic growth, employment generation and poverty reduction all hinge crucially on economic governance. In this context, the concept of economic governance contains a range of issues that have many overlapping elements. Using a broad sweep, these overlapping elements might be grouped into five broad dimensions:

- Defining the Development Vision of the State. The first dimension in addressing issues pertaining to economic governance is the development vision of the state – the map that guides the government in the road to achieving its socio-economic objectives. At the heart of the vision is the balance between the government and the private sector and the extent of discretionary powers over the conduct of the economy that the government would want to assume.

- Creating an Enabling Environment – for business to thrive through government policies and actions. Within its overall development vision, the government initiates, designs, formulates, implements and monitors policies to realize shared objectives and national goals. This process must be credible and sustainable and should inspire the confidence of both domestic and foreign entrepreneurs.

- Fostering Accountable and Transparent Economic Management. The third dimension of good economic governance relates to the extent to which the government adheres to the axioms of good governance, such as accountability, transparency and good economic and financial management in those areas under its direct control. These include public enterprise management, the provision of social services and hard infrastructure such as roads and telecommunications.

- Building the Institutional Foundations for Development. The fourth dimension comprises the role of the government as a facilitator and regulator of economic activity. This dimension covers issues such as the availability of a functioning legal system with clear and simple procedures for enforcing contracts and for defining and defending property rights and for providing a level playing field and a strong and impartial judicial system.

- Promoting Responsible Corporate Citizenship. The fifth dimension covers the creation of the conditions for good corporate governance. Such conditions include the rules and regulations already mentioned, as well as company law that provides the rules protecting the interests of the shareholders. It covers the institutions that can be entrusted to provide a level and competitive playing field and to discipline the behavior of insiders, whether managers or shareholders.

reforms have been evident in the adherence of African policy-makers to four important development guidelines:

- Poverty reduction as an overarching objective.
- The private sector as the main engine of economic growth.
- The state as an effective regulator and facilitator.
- The imperative of meeting the challenge of globalization.

The realization of the objectives, which are stipulated in this development vision, requires effective policy formulation and implementation. In the following sections emphasis will be placed on issues pertaining to State capacity which relates government's ability to implement its policies. State capacity has four dimensions: regulatory, extractive, administrative and technical.

## Regulatory Capacity

African countries are faced with major challenges in their reorientation towards private sector-led growth and the development of private sector participation in the provision of services. To harness the full potential of private sector initiatives, the state would need to address the challenges of establishing effective regulatory rules and ensuring their enforcement. The state also needs to create proper incentive regimes to encourage and sustain private sector participation. The regulatory functions of the state can be grouped into those pertaining to the participation of the private sector in the provision of services and those related to the functioning of the financial system.

### *Regulatory Framework*

Regulation is a difficult and costly business, and wherever possible, competition should be used instead. However, where necessary, the proper design of the regulatory rules and institutions is critical to the objective of increasing private participation in the provision of infrastructure services. The regulatory framework would need to be simple and yet be sophisticated enough to address the fundamental objective of regulation, which is to correct for market failure. The regulatory framework typically includes rules governing entry, exit, scope of participation, and cost recovery. The framework should also provide performance criteria against which the operation of the franchise can be assessed. Hence, to be effective, it should be one that strikes the right balance between removing restrictions on private participation, protecting consumers and safeguarding the country's socio-economic objectives.

The quality of regulatory rules is closely related to the state of political governance, as the latter provides the institutional framework within which regulatory agencies operate. A sound legal framework requires enforcement to be credible. Without effective enforcement, the legal framework and government lose credibility. From the perspective of the private operators, failure to comply with the rules and regulations leads to negative impressions and may damage a country's reputation. As a result, both government and the private sector must have a mutual interest in the transparent and consistent application of enforcement procedures.

An effective regulatory framework cannot be built on a foundation of discipline without appropriate incentives. A sound framework will normally provide proper incentives for the board and management of private firms to pursue objectives that are in the interests of the company and shareholders. As infrastructure often involves sunk investments, an incentive framework that supports cost recovery is a prerequisite for promoting private participation at a level that is mutually beneficial to investor, government and consumer.

An important issue concerns the nature of the institutions responsible for implementing regulatory rules. In general, regulatory institutions are single-industry and/or multi-industry. The choice between multi-industry and a single-industry regulatory institutions has been posed as an issue for African countries for reasons varying from effective regulatory decisions to the absence of the required technical skills, the often small size of the industry, and the cost of regulation. The single-industry approach to regulation certainly provides for specialist experience and expertise in a particular industry, which translates into more effective regulatory decisions. In the case of African countries, it could be argued that it might not be desirable to have as many regulatory agencies as there are utility sectors. Indeed, where the primary function of the regulatory institution is to address issues of income distribution, empowerment, quality of service and cost recovery, the need for consistency and universality in regulatory approaches and decisions is paramount. Moreover, the regulatory decisions from a single source provide investors with a better reading of the government's position on issues of concern to the private investor at a time when sending the "right signals" is an important determinant of private capital flows.

### *Central Bank and Financial Systems*

Among its several functions, the Central Bank has an important supervisory and regulatory role to play to ensure that the banking system operates prudently and efficiently to avoid financial distress. This requires laying down rules for the establishment of new banks, and monitoring procedures to ensure proper accounting and auditing. Also, the Central Bank has a crucial role to perform in the stabilization of an economy, to regulate the level of aggregate demand in the economy.

The central bank should also encourage and facilitate the establishment of other financial institutions, especially institutions to provide long-term loan finance for development, and to provide a market for government securities. Non-bank financial instruments, such as venture capital schemes and bond and equity markets, need to be developed to promote competition and diversification of financial markets and attract foreign portfolio investment.

Central banks in Africa are state-owned and have a powerful role in economic policy-making. In spite of the powers entrusted by legislation establishing central banks in African countries, it has proved difficult in many countries for them to carry out their regulatory duties adequately. Inadequate personnel, both in terms of quantity and quality, can limit the ability to supervise the banking system. In some cases the actual enforcement of regulations is lax, because of corruption or for political reasons.

Making the central bank an independent agency is important both for the development of the financial system and for the effectiveness of monetary policy. The basic argument in favor of independent central banks is the separation of the power to create money from the power to spend money and the prevention of the use of monetary institutions and instruments for political and material gains. Central bank independence means, first, that it has broad latitude to decide what to do in pursuit of its basic goals of macroeconomic stability and employment creation. Secondly, it means that once the monetary policy decisions are made, no governmental organ can reverse them, except under extreme circumstances stipulated by the legislature. A third condition for central bank autonomy is to have independence of personnel; this includes the selection and appointment of board members with a high professional competence and without an obligation to yield to political and other pressures. Finally, it must have instrumental independence, which means control over the instruments that affect the inflation process, including in particular the prevention of any direct financing of government deficits.

## Extractive Capacity

Traditionally, the extractive capacity of the state is confined to the domain of fiscal policy and addresses the extent to which the government is able to extract resources and use them efficiently in the delivery of public goods and services. However, in developing countries where there is heavy reliance on official capital flows, the extractive capacity might be viewed to go beyond the domain of traditional fiscal policy to encompass the manner in which foreign resources are obtained and utilized.

### *Fiscal Policy Management*

In the new democratic dispensation, the power to tax and approve all public expenditure is vested in the legislature, acting in the interest of taxpayers and voters. Their role in sanctioning annual budgets and expenditures must not be merely ceremonial. They must undertake critical reviews, as dictated by the constitution and by their responsibility to taxpayers. Greater parliamentary awareness of the wider economic and political consequences of tax policies and expenditure issues will be required.

Fiscal policy management, which comprises tax administration and expenditure management, is crucial to economic outcomes. Tax policies have significant implications for investment decisions and could be used to enhance national competitiveness and economic performance. Similarly, expenditure management has important ramifications for the performance of government functions and for the economy. Under reform programs many African countries have embarked on improving fiscal performance and the introduction of new tax regimes. In principle, the reform of the tax regime should be guided by three axioms. First, the tax system must promote economic efficiency by limiting its interference in labor, investment and consumption decisions. It should consider the extent to which the tax code alters economic decision-making and the impact of the tax structure on economic outcomes. Secondly, the tax system should involve a strong notion of fairness and strive to ensure that the overall tax burden is fairly distributed among members of society. Thirdly, the administrability of the tax regime should be ensured. What may appear as an ideal tax policy on paper may fail to achieve its objectives on the ground due to the difficulty of enforcing it or a lack of adequate information and education among taxpayers.

A key priority in developing a capable fiscal administration regime is to build a revenue department made up of competent and committed professionals, and a fair integrated tax assessment and collection mechanism. Tax evasion, in which both the taxpayer and tax collector can escape legal censure, is all too common in African countries as a result of corruption and ineffective state institutions. As part of the fiscal reform process, it will be important to find ways to encourage citizens to pay their taxes, to introduce strong checks and balances to minimize corruption, and to put in place strong enforcement systems to increase the risks associated with tax evasion.

On the expenditure side, African governments must begin to keep fiscal expansion within limits that are compatible with domestic stabilization and long-term growth and divert more resources to the vitally-needed services of education and health care. In the education sector, more efforts would need to be made to redirect public resources toward primary education, while relying more on private funding at secondary and higher levels in order to promote efficient and equitable public spending on education. Information technology is an important delivery mechanism which can be employed by governments to provide services cheaply and more efficiently. Of particular importance is the use of information technology to provide education and health care to the rural population at minimum costs.

### *Debt Management and Practice*

For many African countries, the debt overhang places severe constraints on economic recovery and achievement of sustained growth. The basic rationale for debt reduction initiatives is that debt reduction is not an end in itself, but a means to prevent the recurrence of the debt problem. Thus, international efforts to reduce foreign debt must be accompanied by the promotion of internal debt management policies, which aim at optimizing the contribution of foreign borrowing to economic growth and avoiding the emergence of an indebtedness crisis. This necessitates making external borrowings consistent with the government's development and economic management program, particularly to the budgetary process and the balance of payments. Effective debt management system involves many coordinated, interrelated and interdependent functions performed by a number of government agencies. While the organizational arrangements can vary greatly between countries, it needs to be co-ordinated by a central policy unit with authority on all debt matters, with the involvement of top officials responsible for the financial management of the country.

Debt management has two broad classes of integrated functions: Executive Debt Management and Operational Debt Management functions. Effective debt management would require situating the Executive Debt Management (EDM) functions at the appropriate level of government, commitment, endorsement and access to the highest level of government. The representations should be, preferably, at the ministerial level. The main functions of such units involve the regulation of activities of units of government involved in raising and administering external debt and monitoring sources of funds and approaching them with appropriate borrowing techniques. The debt management unit must also create and coordinate statistical and analytical capacity on debt to underpin management decisions.

## Administrative Capacity

Good economic governance requires strong administrative capacity comprising efficient, open, accountable and transparent public service that is competent to help design and implement appropriate policies and manage the public sector. Without an effective public sector and civil service, it would be difficult for the government to formulate or implement sound economic strategies and policies, to create an enabling legal and regulatory framework, and to efficiently provide social services such as education and health. Effective implementation of development policies requires strong administrative capacity not only in central government but also at national, provincial and local levels.

### *Public Sector Management and Civil Service Reform*

Public sector management must play a supportive role to allow private sector operators assume the new role that has been assigned to it. It has to create a sound economic and social environment that is conducive to investment and to enhancing the capacity of a nation's private sector to be internationally competitive. It requires putting in place mechanisms that will enhance and guarantee the quality of public services. Systems must be put in place to strengthen mechanisms for expenditure control, exposure of and sanctions against misspending and corruption. Independent institutions to promote public and private sector accountability – such as the Auditor General's Office, the Ombudsman and the Public Accounts Committee of Parliament – need to be established and given the power to undertake their duties without fear of reprisals. Competent governing boards for public enterprises must be established and promoted.

Efforts to reform public sector management must not be piecemeal and should be consistently implemented if chances of success are to be enhanced. For reform efforts to succeed, they must be guided by a holistic vision, which is shared by the key stakeholders. Public sector reform in African countries will neither be complete nor succeed without also addressing the pay policy for civil service. The need for an efficient and effective civil service will require reform efforts that go beyond cost containment and retrenchment to address the crisis of public incentives that plague African countries. Pay and promotion systems are too often not related to performance. Recommendations to attract and retain highly skilled civil servants include creating a cadre of senior civil service in which entry will be competitive and based only on merit. The senior cadre should be given better professional opportunities and rewarded with higher pay that is close to or even higher than the levels in the private sector. This will require African governments to accept widening differentials between low- and high-skill civil servants. This, it is hoped, will reduce the brain drain from the civil service. The promotion of E-Government (see below) may be one way to help retain a small but highly paid civil service.

Beyond delivering public services, building effective and efficient local governance is increasingly seen as a crucial component of the democratic project in Africa and as way to establish a well-functioning economic and political system. Sustained long-term development in Africa will require viable local governance. The consolidation of local governance is necessary to create the democratic developmental state. This will require not just decentralization but also devolution of authority to local governments and building a viable local political process that can mobilize people and demand accountability from local officials. Effective local governance, which will facilitate long-term growth and development, will require real decentralization. Decentralization must not be used by the central governments as a way to reduce their responsibilities. It must be part of a national strategy to create more responsible and equitable governance. Effective communication must be maintained between central and local governments. Resources should be equitably shared among the levels of government in addition to putting in measures to promote accountability and reduce corruption.

## Technical Capacity

If African countries are to realize sustained economic development, there is a need to build and strengthen the institutions that design and implement economic management. African countries also need to build their capacities in many other areas that support the functioning of political and economic governance as well as the activities of the private sector and civil society. There is, thus, a need to promote the institutions that enhance the capability of the state to govern and the capacity of the private sector to produce. An important components of government capacity is E-Government, which aims to harness the power of information technology in order to increase a government's capacities to provide services and manage the development process.

### Building Supporting Institutions

In the area of political governance, there is an acute need for building electoral assistance support services for the conduct and preparations for the elections. These include the design of electoral and legal frameworks, computerization of electoral roles and the training of election supervisors. Support for local municipal elections and the organization of political referendums are also areas where Africa needs to build capacity. Another related domain is parliamentary support for building legislative capacity in shaping priorities related to the complex issues of accountability, decentralization and constitutional reforms. Promoting access to justice, legal reforms, and legal aid to the poor, civic education and human rights are all areas where many African countries need to build capacity. Equally important are supporting services for consensus building, conflict prevention and information exchange among government and civil society. These supporting functions are best pursued through establishing or strengthening institutions such as parliamentary studies and legislative information centers, Ombudsman offices and human rights institutions and organizations.

There is also a need for national centers to help generate information and knowledge on particular issues and undertake policy dialogue. It is increasingly becoming crucial for policy-makers to have access to information, research and knowledge of issues before making policies. It will be important for government, private sector, and civil society to support the creation such policy centers. Models exist, such as the Nigerian Institute for Social and Economic Research (NISER), and the Al-Ahram Center for Political and Strategic Studies established by the government of Egypt in 1968. To address regional issues, policy centers can be established on a regional basis, such as the Southern Africa Regional Institute for Policy Studies (SARIPS) based in Harare, Zimbabwe.

Institutions that promote technology development in Africa are either non-existent or neglected. African countries would need to establish and promote the institutions that can provide extensive extension services delivering comprehensive packages of assistance comprising technical know-how, finance, management skills, training and sales information. Such institutions are entrusted with the tasks of going into private enterprises to identify their problems and devise appropriate remedies and training packages. They provide information on international standards and quality and give training, consultancy and demonstration services on productivity and quality to small firms at subsidized rates. They also act as technology transfer and technology development agents and provide specialized technical services for new industries.

### Promoting E-Government

E-Government refers to the use of information technology applications to perform government functions with maximum efficiency and at minimum cost. Most African countries need to enhance their capacity in this regard. Information systems which can help governments design, implement, and assess the effectiveness of economic measures are now powerful instruments of public policy. Such information systems could increase the speed, volume, quality, transparency, and accountability of government transactions, yielding large productivity increases in government services.

In fiscal monitoring, governments can use information systems to design and follow-up the process of tax collection and validate its revenue collections against its expenditure. In budgetary planning, information technology provides simulation techniques to simultaneously maximize revenue and minimize the tax burden on selected income groups and economic actors. In public procurement, the adoption of information technology can help simplify purchasing procedures through electronic advertising, qualification, tendering, selection and payment. It must be underscored, however, that information technology is not a panacea in itself. It is rather a powerful tool that can bear results only if it is put into effective use. And to do this, African countries would have to overcome, as a matter of priority, numerous obstacles including the inadequate state of telecommunications services and the high cost of computers and software.

## Corporate Governance

The use of the term governance has become almost synonymous with civil or political governance. But in recent years, the importance of both economic and corporate governance has come to the fore. The relationship among political governance, economic governance and corporate governance is analogous to a series of concentric circles in which the political governance forms the outside circle, followed by economic governance circle, with corporate governance at the center.

Political governance sets the orientation of the economy and it supplies the institutional infrastructure for economic governance. In turn, economic governance provides the context in which corporate governance is practiced. In particular, it provides the laws under which corporations are established and the regulatory framework for the conduct of corporate affairs, and sets the macroeconomic framework. Corporate governance, thus, stands at the intersection of law, public policy, and business practice. Robust corporate governance in Africa should be responsive to the needs of internal and external stakeholders and must be based on political and legal traditions of the country. The key challenge facing African countries will be to devise the corporate governance institutions that can help nurture and regulate the private sector in order for it to fulfil its developmental role.

Corporations must be able to tap both domestic and international capital markets in today's world. Increasingly, individual investors, funds, banks, and other financial institutions base their decisions not only on a company's outlook, but also on its reputation and its governance. It is this growing need to access financial resources, domestic and foreign, and to harness the power of the private sector for economic and social progress that has brought corporate governance into prominence. It is for these reasons that countries are now beginning to realize that just as public governance is important in the public sector so also is corporate governance in the private sector. Public governance can have a major impact on private corporate behavior. Sound governance of corporations is potentially a source of competitive advantage and critical for economic performance and social progress.

From a corporation's perspective, the emerging consensus is that corporate governance is about maximizing value, subject to meeting the corporation's financial and other legal and contractual obligations. In a narrow sense, corporate governance can be viewed as a set of arrangements internal to the corporation that defines the relationships between managers and shareholders. The shareholders may be public or private, concentrated or dispersed. Corporate governance, from the public policy perspective, is about nurturing enterprises while ensuring that they are accountable in their exercise of power and patronage. Public policy aims to provide firms with the incentives and discipline to minimize the divergence between private and social returns in addition to protecting the interests of stakeholders. Another dimension of the public nature of the corporation is to view private companies as serving not only the interest of, or responsible to, the shareholders alone, but the larger society as well. This raises the issue of the accountability of the corporation.

Corporations, especially large corporations, must be seen as social enterprises because their activities affect not just the shareholders but also the larger society. In particular, the decisions of the big corporations can affect unemployment, trade, the physical environment and other aspects of society. As such, the corporation should act as a socially responsible citizen, and should incorporate social considerations into its operations. This is the idea of corporate social responsibility, which entails incurring costs for socially desirable but not legally mandated action. It involves a corporation making positive contributions to the development of the communities in which it operates in the hope that the company will do better as a result of accrued goodwill.

Corporate governance requires institutions that can be entrusted to provide a level and competitive playing field and discipline the behavior of insiders, whether managers or shareholders. These institutions and policies, which are more developed in the advanced market economies, minimize the divergence between social and private returns. They also reduce costly agency problems, primarily through greater transparency, compliance mechanisms, and monitoring by regulatory and self-regulatory bodies. Key among the institutions and instruments are the legal framework for competition policy, the legal machinery for enforcing shareholders' rights, systems for accounting and auditing, a well-regulated financial system, the bankruptcy system, and the market for corporate control.

## Global Dimensions of Governance

An important driving force in the evolution of governance has been the global phenomenon, which has virtually reduced the world to a global village. For the first time in history, almost all of the world's people are bound together in a global economic system. At the same time there is pressure for convergence in political systems towards a global order of democracy. It is therefore not surprising that this century has often been dubbed the democratic century with the rise in the number of sovereign states from 55 in 1900 to 192 in 2000 while the number of democracies increased from zero to 120 respectively. According to UNDP, in 1999 alone, 90 countries conducted local elections and created 1,621 jurisdictions at the intermediate level and a staggering 478,000 jurisdictions at the local government level. Clearly, domestic pressures for good governance have been driven by international compulsion.

Globalization is altering both the world's economic and political landscapes in fundamental ways driven on one hand by a widespread push towards the liberalization of trade and capital markets, increasing internationalization of corporate production and distribution strategies, and technological change, which is rapidly dismantling barriers to the international tradability of goods and services and the mobility of capital. Globalization, on the other hand, is also observed in the power of inter-governmental institutions and in the spread of transnational corporations while states are bound together by a web of multilateral and bilateral agreements that create mutual binding obligations and place governments under greater scrutiny.

Globalization thus, has profound implications for governance, including the erosion of state sovereignty as transnational bodies increasingly mediate national concerns and press for universal laws. But it also offers opportunities to expand pluralism, legality and liberty. In this context the role of the state is to find a balance between taking advantage of globalization and providing a secure and stable social and economic domestic environment. Some of the notable global dimensions of governance include the impact of foreign aid (see Box 3); the global trading system; global financial architecture; corruption; preventing and controlling conflicts; and information and communications technologies. Of special relevance to Africa's development prospects is the governance of the global trading system.

Despite the enormous, indeed, unprecedented scope for increased economic freedom under the WTO, Africa has, over the last three decades, lost trade equal to about 20 per cent of GDP – far more than it has received in aid (ADB et al., 2000). This loss reflects partly inappropriate policies, lack of diversification of products and markets, declining terms of trade, and above all unrelenting protectionist policies in industrial countries. While new structures of global trading governance can increase Africa's market access and clarify its rights in the international trading framework, several factors have limited the effectiveness of African participation in previous multilateral trade negotiations, up to and including the Uruguay Round. There is, first, a perception that the processes and mechanisms associated with these negotiations were "unbalanced" and weighted against poor, developing countries. The developed countries are seen to have packed the negotiating agenda with issues of interest to them and to have kept introducing new issues before the developing and least-developed countries have managed to acquire sufficient information and knowledge on the emerging "new issues" as a basis for engaging in meaningful negotiation. In addition, the decision-making mechanisms associated with these negotiations have typically been less than fully transparent; the developed and larger countries invariably settle the most crucial issues in "closed" meetings and in consultations among themselves.

Above and beyond these in-built biases of the WTO process are the inherent inadequacies of the African participants. Studies suggest that many African countries have generally been overwhelmed by the complexity of negotiations and the technical nature of many issues being discussed and/or negotiated. This could be attributed to the lack of technical expertise and negotiating experience on the part of many African negotiators exacerbated by the dearth of in-depth analysis of the implications of various proposals from the perspective of specific national interests and by the absence of appropriate and timely support and guidance from the negotiators' home-based principals. This calls for regional co-ordination of African trade policy, particularly in the WTO process as such regional organizations could play an important role in enhancing African capacity to participate effectively. In particular, these organizations can, through the pooling of resources, provide services to their member states in a more cost-effective way than when the member states act on their own.

**Box 3: The Impact of Aid Delivery Mechanisms on Governance**

Aid has had a significant impact on development in Africa. Despite the success in certain areas, aid delivery mechanisms have been shown by various studies (undertaken by both donors and the recipient countries) to have some unintended negative impacts on governance. This is especially important given the fact that donors loom large in Africa and play a crucial role in determining what is done and how things are done in various aid-dependent and vulnerable African countries. Some of the implications of aid delivery mechanisms on governance are:

**Weakened ownership of development policies and programs:** Aid tends to come with conditions. The aid programs are rarely negotiated with broad local consultation and so are widely seen by Africans as being an external imposition. The result is a lack of ownership and commitment. Furthermore, aid programs are highly fragmented with multiple donors pursuing different priorities with different procedures. Compounding the problem is the fact that there are no efforts to coordinate different aid programs. In addition, the habit of creating special implementing units weakens the civil service as the best civil servants are siphoned away to work on aid programs as project managers. This fragmented approach to aid delivery prevents integrated management of public spending.

**Less accountability to recipients:** With 50 percent or more of some countries' budgets funded by donors, there is less incentive to strengthen domestic accountability and economic governance for the use of resources. With the tendency for donors to micromanage aid in some highly aid-dependent African countries, development activities are geared primarily towards satisfying their demands. Aid is not the cause of weak institutions in Africa but, in an environment where institutions are already weak, aid can make recipient governments less accountable to their people.

**Capacity-building and destruction:** Despite massive spending on provision of technical assistance to African countries, aid programs have probably weakened capacity in Africa. Yet, capacity-building (human and institutional) is a crucial factor in addressing many aspects of development, including governance. Technical assistance has displaced local expertise and drawn civil servants to administer aid-funded programs. This is precisely the opposite of what aid is intended to do—build capacity. With tied technical assistance, most of the benefits flow back to the donor country. The end result is less impact on recipients' economies and a negative impact on human and institutional capacity-building in some extreme situations.

**Reduced sustainability and transparency:** Aid and its reforms have not been well understood in Africa, partly because people are not involved in the design. As a result, recipient countries tend to have a limited understanding of what aid and its reforms are intended to achieve and how they can be achieved. This is especially so where complicated reforms or technical assistance programs have been urged on governments. In most cases, parliaments are not involved in the discussion despite sizeable budget impacts. Additionally, many donor initiatives are not integrated within national budgets and national development plans. Donors have supported capital investments without adequate attention to the need for counterpart funding and additional domestic resources to operate and maintain facilities. As such, many funded capital programs do not get the additional funding and support that is needed to ensure sustainability and effective utilization.

**Excessive debt:** High debt crowds out the effect of new aid because in stagnant economies rising debt service drains fiscal resources needed for development, and a large stock of debt raises questions about policy credibility and sustainability of reforms. The large volumes of unserviceable debt may pressure donors to continue to fund countries despite weak development policies and may reduce a recipient's sense of accountability for outcomes. In such an environment, the impact of new aid may not offset the negative effects of the debt stock.

*Source*: Adapted from ADB et al. (2000).

## Bank Group Policy on Governance

The Bank's role in governance issues has evolved over the years, and good governance has taken on increasing importance in its mandate of contributing to the economic development and social progress of its regional member countries (RMCs). In this respect it is not only the Bank (Box 4), but also its member countries that have awakened to the importance of good governance for economic efficiency and growth as more is learned about the contribution that good governance could make to the macroeconomic stability and sustainable growth of RMC's. While the acceleration of economic growth and the reduction of poverty remain the Bank's development priorities in all its RMC's, increasingly the Bank has found that a much broader range of institutional reforms is needed if countries are to establish and maintain private sector confidence and thereby lay the basis for sustained growth. The issues of governance that are of concern to the Bank include:

- Ensuring accountability of public agencies and officials at the levels of Public Sector Management, Public Enterprise Management and Reform, Public Financial Management, Corporate Governance, and Civil Service Reform, through formal transparent processes for monitoring and reporting;
- Fostering transparency at all levels of government and public administration, including budgetary transparency in terms of Information Disclosure, Public Expenditure Reviews (PERs), Capacity in Public Policy Analysis and Dissemination;
- Combating corruption by Support for Research on Corruption, Prevention and

**Box 4: The Bank Group: Internal Governance and Institutional Reforms**

By mid-1995, the Bank Group was experiencing serious issues of governance pertaining to relations among major shareholders as well as to the internal management of the institution. The governance crisis put into doubt the ability of the institution to continue to meet its development mission. In September 1995, the governing bodies of the Bank mandated a new management to institute a wide-ranging reform program.

The reform program had four main goals: first, to improve the quality of Bank operations; second, to strengthen its financial management; third, to overhaul the organizational and management structure of the Bank and to enhance its efficiency; and fourth, to improve its institutional governance.

*Enhancing Operational Effectiveness:* In respect to operations, the reform measures have focused on improving project quality and the development effectiveness of the Bank's lending program. Sector policies that guide Bank operations have been updated and new policies have been formulated. An important milestone in this regard was the adoption of the Bank's Vision statement in 1999. The Vision identifies priority areas for the Bank's interventions in regional member countries. The Bank Group has enhanced its Country Strategy Papers, which are now its main programming tool for lending and technical assistance. These are prepared in a participatory manner involving borrowing countries, our development partners, and other major stakeholders. For ongoing projects, the consolidated Annual Portfolio Performance Review process has enhanced the quality of the Bank's loan portfolio by reducing the proportion of problem-projects. As part of a medium-term plan to gradually strengthen its presence in regional member countries, the Bank opened six country offices in 2000. This will enable the Bank Group to monitor more closely its portfolio and to coordinate better its

**Box 4: (Continued)**

operations with clients and other development partners.

*Strengthening Financial Management:* The Bank has implemented a comprehensive financial reform program aimed at strengthening its policies relating to loan recovery, balance sheet risk management, borrowing, and liquidity management and to ensure that the risks inherent in the Bank's activities are adequately covered. In line with best practices, the Bank has established an Asset Liability Management Committee to provide oversight for the implementation of its financial activities. As part of its financial reform program, the Bank has also introduced new financial products that more adequately respond to client needs as well as improve their debt-servicing capacity. The Bank is, for example, among the first multilateral financial institutions to introduce Rand-denominated loans for its borrowers in Southern Africa.

*Enhancing the Bank's Organizational and Management System:* Following the major re-organization of the Bank in early 1996, the Bank's human resource management system has been rationalized through a series of measures including the introduction of new staff performance evaluation and job classification systems, and an improved staff remuneration and benefits package, revision of the staff rules and regulations, and strengthening the staff appeals process, and a comprehensive staff training program, including a Management Development Program. The Bank has also put in place an Information Technology and Telecommunications Modernization Program. This aims at improving and strengthening the quality and efficiency of Bank Group operations, as well as facilitating the adaptation of the Bank to its changing business environment.

*Resource Mobilization and Institutional Governance*: The final area of reform that the Bank has been engaged in during the last five years has involved strengthening its fundamental governance structures. These reforms have had as their goal enhancing the Bank's operational efficiency, strengthening its financial standing, and preserving the rights and interests of its member states. Accordingly, in May 1998, the Board of Governors authorized a fifth general capital increase of 35 percent, and a restructuring of the Bank's capital base. It also approved the establishment of the Governors' Consultative Committee (GCC).

The reforms in all these four areas have been substantially completed and are beginning to yield fruits. One immediate outcome of the enhancement of the operational effectiveness is that our lending operations have doubled over the last five years and have averaged US$1.7 billion in the last two years. The Bank's high financial credit rating, which ensures that we are able to minimize the cost of funds to clients, is backed by prudent financial policies, membership support and a solid capital structure. As a consequence, the Bank Group has now regained its place among the MDBs, and stands as the premier development finance institution for the continent. It has also made great strides to fulfil its mission of mobilizing resources from its development partners, and to contributing to Africa's social and economic development. The continued success of the Bank Group in the coming years will depend on continued support from its governing bodies and on building stronger partnerships with its regional members and development partners.

*Source:* Omar Kabbaj (2000).

Control of Corruption in Bank-financed Operations, Sensitization and Provision of Assistance to RMCs;

- Fostering greater participation, and freedom of speech and association, to enable the beneficiaries of government programs to participate effectively in determining and meeting their needs, as well as co-operation with NGOs, CBOs, and CSOs, Economic Co-operation and Regional Integration, Support for Decentralization at Various Sub-National Levels, Public Sector/Private Sector Interface;
- Nurturing an objective and efficient judiciary through the creation of a predictable legal environment; and,
- Enhancing efficiency within public and private institutions by building technical and management capacities using its instruments of Economic and Sector Work, Advocacy and Policy Dialogue, and Lending and non-Lending Activities.

## Operationalizing Good Governance in Bank Group Activities

Good governance is important for all countries and the responsibility for governance issues lies first and foremost with the national authorities. The Banks efforts therefore should, wherever possible, build on the national authorities' own willingness and commitment to address governance issues, recognizing that its involvement is more likely to be successful when it strengthens the hands of those in the government seeking to improve governance. However, there may be instances in which the authorities are not actively addressing governance issues of relevance to the Bank. Thus in operationalizing its agenda for good governance, the Bank will seek to promote good governance in all its aspects, including ensuring the rule of law, improving the efficiency and accountability of the public sector, and tackling corruption as an essential element of a framework within which economies can prosper. The Bank will thus be guided by the following:

- The country's institutional capacity, social and political situation.
- The need to take into consideration the effects of bad governance on development performance;
- The ownership of development programs and policies by RMCs; and
- The concern for effective partnership among government, private sector, civil society and the international development community in the implementation of governance initiatives.

Given the complexity of governance issues and the interrelated nature of its different components, the Bank's interventions will be selected from a range of activities taking into account the interrelations between the different axioms of good governance, country circumstances, the state of dialogue with the country and budgetary and staff constraints. The Bank Group contributes to promoting good governance in its RMCs through different channels. First, in its policy advice, the Bank has assisted its member countries in creating systems that limit the scope for ad hoc decision making, for rent seeking, and for undesirable preferential treatment of individuals or organizations. To this end, the Bank has encouraged, among other things, liberalization of the exchange, trade, and price systems, and the elimination of direct credit allocation. Second, Bank technical assistance has helped member countries in enhancing their capacity to design and implement economic policies, in building effective policymaking institutions, and in improving public sector accountability. Third, the Bank has promoted transparency in financial transactions in the government budget, central bank, and the public sector more generally, and has provided assistance to improve accounting, auditing, and statistical systems. In all these ways, the Bank has helped countries to improve governance, to limit the opportunity for corruption, and to increase the likelihood of exposing instances of poor governance. In addition, the Bank has addressed specific issues of poor governance, including corruption, when they have been judged to have a significant macroeconomic impact.

## Conclusion

In recent years, the issue of governance has been given new impetus by five important factors. First, the development failures of the African continent in the 1980s, in particular, the difficult experience with and mixed record of structural adjustment reforms. Second, the recognition of the failure of command economies and the emergence of a consensus on the relative efficacy of neo-liberal development strategies. Third, the rise of pro-democracy movements in Africa and other parts of the developing world, with the demand for good governance and more responsive forms of government as a rallying point. Fourth, the growing concern that widespread corruption is siphoning away both domestic and external resources. And fifth, the phenomenal increase in globalization and its even stronger imperatives for sound domestic policy environment and economic management.

There is consensus that good governance should build on: (i) effective states; (ii) mobilized civil societies; and (iii) efficient private sectors. All three factors are necessary for sustained development. Effective states create an enabling political and legal environment for equitable economic growth. Active and vibrant civil societies mobilize individuals, groups and communities, facilitate political and social interaction, help to generate social capital, and foster societal cohesion and stability. Productive private sectors generate jobs and income. There is also a wide consensus that the key elements of good governance include accountability, transparency, combating corruption, participatory governance and an enabling legal/judicial framework.

Globalization has profound implications for governance, including the erosion of state sovereignty as transnational bodies increasingly mediate national concerns and press for universal laws. Another dimension is the increased globalization of political, social, economic and environmental problems. Thus good governance cannot be considered a closed system. The role of the state is to find a balance between taking advantage of globalization and providing a secure and stable social and economic domestic environment. Against this background, governance can more appropriately be defined as: "the manner in which power is exercised in the management of the affairs of a nation, and its relations with other nations". It follows, therefore, that solutions to some governance problems, such as a reduction in corruption and excessive military expenditure, can be facilitated by actions at the global level. However, though recognizing the important dimension and implications of globalization, this policy focuses more on the national elements of good governance.

The Bank Group's interest in governance arises from its mandate to ensure the effectiveness of the development efforts it supports. It is also in line with the Bank's Vision for sustained African development in the 21st Century. For the Bank Group the key elements of good governance include accountability, transparency, combating corruption, participatory governance and an enabling legal/judicial framework. The Bank acknowledges the complex nature of governance issues, and is aware that, the work in this area is likely to prove difficult and may not yield quick results. It recognizes the need for a long-term engagement and differentiated approaches between regions, countries and project types.