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PERSPECTIVES ON CONTINENTAL FINANCING AND THE ROLE OF DEVELOPMENT AND OTHER FINANCE INSTITUTIONS

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PERSPECTIVES ON CONTINENTAL FINANCING AND THE ROLE OF DEVELOPMENT AND OTHER FINANCE INSTITUTIONS*

1. INTRODUCTION

The principal objective of economic development policy is to raise real per capita incomes of the majority of people. To achieve this, a host of complementary ingredients, including the capacity to generate adequate domestic savings and to finance productive investments, must be put in place. If recovery and development in Africa is to quickly materialize, a fuller appreciation of the package is essential. The purpose of this paper is to attempt to put into sharper perspective how and in what environment continental financing and development and other finance institutions can contribute effectively to economic recovery and development in Africa. In the process, it is hoped to show that development financing, as critical as it is, has to be combined with a host of other appropriate factors in an effort to promote African economic recovery and development.

First, the paper briefly reviews in retrospect the past experience of development financing focusing on what might have gone wrong in Africa as compared with Asia and Latin America. This is followed by a brief appraisal of the recently adopted strategies and priorities for the continent as found in Africa's Priority Programme for Economic Recovery, 1986-1990 (APPER). Next, the paper shall discuss some issues related to financial resource requirements and mobilization for the implementation of APPER or the United Nations Programme of Action for African Economic Recovery and Development, 1986-1990 (UN-PAAERD). Finally, the paper endeavours to place the role of development and other finance institutions in promoting recovery and development in the continent in the context of the current economic crisis in Africa.

2. HISTORICAL PERSPECTIVE ON DEVELOPMENT FINANCE

In retrospect, economic development policies during the early part of post-independence period were influenced by development models which emphasized capital resources as the most crucial and missing ingredient in the development process. 1/ It was believed that, given abundant natural and human resources, all that was required was a massive inflow of external capital to supplement low domestic savings in order to move the African economies up the stages towards a "take-off" into self-sustained growth.

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* This paper was prepared by B.C. Muzorewa of the African Development Bank. The author greatly acknowledges comments by colleagues but the views expressed remain his own and in no way represent those of the Bank.

1/ Todaro, M.P., Economic Development in the Third World (Second Edition 1981) pp. 57-61 provides a good summary of these models.

Thus, capital inflows were encouraged, with grants to developing countries and to multilateral institutions constituting over 70 per cent of Official Development Assistance (ODA) between 1961 and 1968. 2/ Of the total net ODA flows from Development Assistance Committee members and multilateral agencies to developing countries between 1964 and 1967, some 56.3 per cent went to Asia, followed by 27.2 per cent to Africa, and 16.6 per cent to Latin America. Thus, Africa was certainly not the least recipient.

The question that immediately arises is whether or not these aid inflows did in fact supplement domestic savings and were accompanied by growth in incomes. Evidence shows that growth rates in per capita income in constant prices were positive for all the above developing country regions. For Africa, per capita gross domestic product growth rate averaged 1.6 per cent between 1960 and 1967, equal to that of Latin America and only 0.9 percentage points less than that for all developing countries. 3/ The savings and investment ratios for Africa exceeded those for Asia. When growth in sector output is compared, it shows that African growth rates in agricultural output and in export earnings exceeded the respective growth rates registered in South Asia between 1960 and 1967. Between the same period, African manufacturing output grew faster than that for Latin America. In all these indicators, African performance was below that of all developing countries put together by less than 2 percentage points. 4/

The conclusion so far, therefore, is that during this period, Africa received comparable levels of foreign development assistance and those inflows appear to have been accompanied by comparable savings and investment ratios and output growth rates. Thus, the development models which emphasized the role of capital inflows appear to have been vindicated and this resulted in a rapid increase in capital flows, not only of development assistance but also of private commercial flows.

From the early 1970s, total debt finance to Africa increased at an average annual rate of over 20 per cent between 1970 and 1980. 5/ But, the developments in output per capita since the early 1970s indicate that something went wrong in Africa alone. This is confirmed by evidence that, while Asia and Latin America continued to register positive growth rates, African growth rate,

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2/ Pearson L.B., Partners in Development - Report of the Commission on International Development (London, Praeger Publishers, 1969), p.140.

3/ Pearson, ibid., p.358.

4/ Pearson, ibid.

5/ Muzorewa, B.C., External Finance and Development Policy in Africa, (Abidjan, ADB, March, 1987), a staff economic research paper forthcoming.

for instance, in food production per head, has been declining from 0.9 per cent in 1961-1970 to -1.3 per cent in 1971-1980 and -1.9 per cent in 1980-1984. 6/ Growth rate in per capita GDP is shown to have declined from 1.8 per cent in 1961-1970 to 1.2 per cent in 1971-1979 and further to -2.4 per cent in 1980-1984. 7/ During the same period, savings and investment rates also declined. In the 1960s, Africa's population growth rate was comparable to those of Asia and Latin America. But since then Africa's population growth rate has risen above those of other regions and this has contributed to the decline in per capita output.

Why then has Africa lagged behind other developing regions? It could not be due to external factors alone because these other regions are facing more or less the same external environment. The answer seems to lie in the degree of attention given to removal of structural rigidities of domestic origin. These other regions must have been more receptive to the structuralist models of development which recognized the existence of domestic and external structural and institutional rigidities in the way towards self-sustained growth. 8/

According to these models, development-inducing role of domestic and foreign capital will be limited by internal or domestic structural factors such as: research, technological progress and education; availability of skilled manpower, management and a pool of modern entrepreneurship of indigenous origin; capacity to analyse and formulate appropriate economic strategies and policies and to identify, prepare and administer priority projects and programmes. In addition to these domestic constraints, developing countries face hostile external institutions (such as the international monetary and financial system, the trading system and commodity markets) and environment over which they have no control. These include inaccessibility to markets of developed countries, adverse terms-of-trade, high real interest rates on international capital markets, unavailability of concessional external financial resources, and drought. Where a host of domestic structural rigidities still exist and where inappropriate substitutes are in place, the adverse impact of external factors is bound to be more severe.

Thus, Asia and Latin America appear to have been able to reduce effects of the above external rigidities by paying full attention to the elimination of constraints within the control of their governments. Otherwise, how, for instance, could Asia have continued to expand its exports during the deep recession of the early 1980s while Africa's exports declined? There is no doubt that Asia may have increased exports through development of manufactured products while Africa continued to export traditional primary commodities. But, why was Africa unable to also develop manufactured products for export

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6/ McNamara, R.S., The Challenges for Sub-Saharan Africa (Washington, D.C., November 1985) p.39.

7/ McNamara, ibid., p.36.

8/ Todaro, op. cit., pp.62-64.

despite freer access to European countries due to preferential treatment? As alluded to above, the above fundamental and structural rigidities or constraints of domestic origin appear to have been given less attention in Africa than elsewhere. These factors need to be removed to clear the way towards a more effective role of development financing in promoting economic recovery and development in Africa.

3. RE-APPRAISAL OF PRIORITIES AND STRATEGIES

In the light of these disturbing trends and particularly the consequences of the 1983/1984 drought, African Heads of State and Government held a Summit in 1985 on economic issues to diagnose the causes of the problem and to formulate new strategies and policies designed to reverse the declining trends in their economies. In retrospect, the Heads of State and Government made a crucial decision by providing a clear picture of the place of responsibility for achieving economic recovery, self-reliance and self-sustained growth in Africa when they said:

> "We re-affirm that the development of our continent is the primary responsibility of our Governments and peoples. We are, therefore, determined to take concrete actions and measures individually and collectively for the achievement of the economic development of our continent in unity and solidarity of African peoples and member States." 9/

This re-affirmation of the place of primary responsibility for the continent's development is very important for the purposes of this paper because it provides a clear identification of the sources of efforts and resources which are required to achieve economic recovery, self-reliance and self-sustained growth in Africa. In other words, the forces of development are basically of domestic origin, with external favourable forces only supplementing internal ones. Such a broad re-orientation is critical because it permits a clearer focus on those rigidities of domestic origin. Only then can these factors be more clearly identified and removed, thereby promoting growth, product diversification, and reducing the adverse impact of and Africa's vulnerability to external hostile factors.

In this connection, one of the most important domestic factors is a set of micro- and macro-economic policies of the country. The formulation of the micro- and macro-economic policy framework, based on a thorough understanding of the workings of an economy, can have far-reaching structural positive consequences on the entire economy. APPER recognizes the importance of policy reforms as evidenced by the admission that policy shortcomings also contributed to the crisis and the fact that policy reforms constitute one of the major priority areas. 10/

9/ OAU, Africa's Priority Programme for Economic Recovery, 1986-1990, (Addis Ababa, July 1985), paragraph 6.

10/ United Nations, United Nations Programme of Action for African Economic Recovery and Development, 1986-1990 (New York, June 1986) page 12, paragraph 11 (i).

A further review of APPER, as endorsed by the international community, shows a clear identification of priority areas in which domestic rigidities or bottlenecks have to be removed. By isolating food and agriculture as the top priority sector, this opened the way for removing a host of institutional and policy impediments to the increase in production, employment and incomes in a sector where over 70 per cent of the population earn their livelihood. As APPER says, Africa has adequate potential for agricultural development and all that is required is wise and careful exploitation of this potential. In recognition of linkages involved, APPER also includes activities which are supportive to agriculture. These are industries producing inputs into and using output from agriculture; transport and communications designed to move agricultural inputs and output; marketing and payments facilities; combating drought and desertification; human resource development, planning and utilization; and policy reforms. Thus, an agricultural-oriented development strategy is what APPER is all about.

That this is an appropriate strategy under the current situation given the resource base in Africa is not in any doubt. However, from a long-term development point of view, this strategy has potential dangers of failing to articulate critical strategies for other sectors. There are three main reasons. First, it has been shown that the growth of agricultural production has natural limits while manufacturing based on wise and careful selection of projects can grow at much higher rates and create higher employment. Second, as already mentioned above, the effects of micro- and macro-economic policy reforms are likely to spill over into non-agricultural related activities of other sectors. Third, multiplier effects from and to agriculture and closely related activities in other sectors can be traced beyond these activities - that is to or from manufacturing, mining and services activities which are unrelated to the food and agriculture sector. As has long been shown, for instance, unless incentive goods (which are also produced by non-agricultural related industries) are available, the efforts to increase agricultural production and incomes could be dissipated. Thus, within the agriculture oriented strategy, care has to be taken to ensure that appropriate strategies in other sectors which may not be directly linked with agriculture but which have long-term greater potential for propelling the economy into self-sustained growth, are well articulated.

4. SOME ASPECTS OF RESOURCE REQUIREMENTS AND MOBILIZATION

4.1 Total resource requirements

The objective of APPER and UN-PAAERD is to reverse the declining trends in per capita GDP. To achieve this, domestic constraints have to be removed and the international environment has to become more favourable than at present. One critical element of the strategy is, of course, the magnitude of resource requirements estimated to be $ 128.2 billion broken down as in table 1. The question that immediately arises is: will this amount of investment succeed in reversing the declining trends in per capita GDP growth rate in Africa? Alternatively put, what target growth rate in GDP is consistent with this amount of investment?

According to Africa's submission to the United Nations special session,

"...should Africa's Priority Programme for Economic Recovery be fully implemented, and should the economic environment improve significantly, Africa's GDP may resume the annual growth rates of the 1970s". 11/

Table 1: Resource requirements for the implementation of APPER by priority activity, 1986-1990

		$ billion	Percentage
1.	Agriculture	57.4	44.8
2.	Other sectors in support of agriculture	60.4	46.9
3.	Drought and desertification	3.4	2.7
4.	Human resource development	7.2	5.6
5.	Total	128.1	100.0

Source: OAU, Africa's Submission to the Special Session of the United Nations General Assembly on Africa's Economic and Social Crisis (Addis Ababa, March 1986) page 71, paragraph 225.

Since real growth rate in GDP was about 5 per cent per annum between 1975 and 1979 and since population growth rate is projected to be about 3.6 per cent per annum from 1985 to 1990, a growth rate in per capita GDP of 1.4 per cent is expected. But the question still remains as to the consistency of the $128.1 billion of investment with the target growth rate in GDP of 5 per cent. Very rough calculations seem to indicate that this amount of investment is likely to generate a growth rate in GDP ranging from 2.5 to 3.3 per cent, and therefore will not succeed in raising per capita GDP growth rate to positive levels. 12/ To achieve close to 5 per cent average annual growth rate, the required total investment would have to be about $192 billion over the five-year period, assuming a capital output ratio of 3. However, with a capital/output ratio of 4, the growth rate in GDP (3.7 per cent) would still yield a small but positive growth rate in per capita GDP. The conclusion here is that OAU estimates for APPER appear to be not high enough to restore growth rates in GDP of the 1970s as envisaged.

11/ OAU, Africa's Submission, op. cit., pp. 54-55, paragraph 165.

12/ Using a simple formula: $AY/Y = I/Y.\ 1/k$, where k is the capital/output ratio assumed to range from 3 to 4. The lower capital/output ratio reflects the dominance of the agriculture sector which is generally found to have the lowest ratio among all sectors of the economy.

The above aggregate estimates only indicate the broad order of magnitude, considering the complexity of the exercise. But the point that needs emphasis here is that resource requirements per unit of inputs in Africa today are inevitably larger than those which were applicable to the now industrialized countries when they were at the present level of African development. There is one main reason for this. When the present industrial countries were developing, technology was very simple and inexpensive. As also observed by Newlyn,

> "The scale of investment required by modern technology is vastly greater in relation to income per capita than the relatively small technological innovations associated with early developing countries". 13/

For present-day Africa, the cost per unit of imported capital goods, raw materials and essential services is much higher than it was for the then developing countries in the nineteenth century. Thus, even if all other co-operating domestic factors are available, relatively larger amounts of resources are required per unit of investment for Africa to achieve recovery and development.

4.2 The potential for domestic resource mobilization

We have seen from the above that the amount of resources required for African recovery and development is considerable. The African submission also shows that the share of these resources to be generated locally exceeds 60 per cent of the total. Such proportions are, of course, consistent with the principle of self-reliance and the fact that domestic savings growth is the basis for sustained growth. But does the potential exist in Africa for generating so much of domestic resources?

In response to the commitment by African countries to raise 64.4 per cent of resources for the implementation of APPER/UN-PAAERD, the African Development Bank commissioned a study on domestic resource mobilization in Africa for the period 1965 to 1984. 14/ First, the study observes that the potential to raise domestic saving rates has been deteriorating as evidenced by the fact that the marginal propensity to save is exceeded by the average propensity to save. Second, the Bank study shows that more important determinants of savings in Africa appear to be the general income level, export levels and taxation, in that order. These conclusions mean that policies for domestic savings mobilization need to be directed at increasing incomes, exports and the efficiency in public sector enterprises, tax revenue collection and government expenditure programmes. Considering that incomes in Africa are largely dependent on exports and that export growth is largely determined by the external environment, the task of mobilizing domestic resources for APPER is a mammoth one for most African countries.

13/ Newlyn, W.T., The Financing of Economic Development (Oxford, Clarendon Press, 1977) p.320.

14/ ADB, Domestic Resource Mobilization in Africa, research in progress with the assistance of Mr. J. Frimpong-Ansah, consultant. A summary of the preliminary findings is contained in: ADB/ECA, Economic Report on Africa, 1987 (Abidjan and Addis Ababa, March 1987) Part II.

Given this rather bleak internal environment for increased domestic resource mobilization and the reality that external environment for mobilizing foreign resources is becoming increasingly unfavourable, there is no alternative but to take extraordinary and innovative measures to mobilize the required resources.

For instance, the study at the Bank referred to above suggests the possibility of introducing a special APPER tax on private consumption. 15/ According to sources of the Economic Commission for Africa (ECA), total private consumption in Africa averaged \$206 billion between 1981 and 1985. 16/ If a special APPER tax rate of only 5 per cent had been introduced, this could have yielded \$10.3 billion per year (or \$51.5 billion over a 5-year period). This would constitute 41.7 per cent of the domestic component (64.4 per cent or \$123.6 billion) of the \$192 billion required to achieve positive growth rates in per capita GDP. As a share of the OAU estimates of domestic resource requirements of \$82.5 billion, the special tax revenue would be 62.4 per cent. The tax rate suggested here may appear to be burdensome for the low-income groups, but the size of domestic resources required for APPER indicates that such sacrifices may be worthwhile.

Doubled efforts should also be made towards more efficient utilization of resources, whatever their source. More efficient use of resources (both financial and human) is an important form of resource mobilization, a fact which has not been given the attention it deserves. Very often scarce financial resources are wasted as a direct result of inefficient use or misallocation of human resources (both skilled and unskilled) and mismanagement of parastatal organizations resulting in huge perpetual losses.

The magnitude of domestic resources envisaged under UN-PAAERD further calls for intensification of efforts to create a conducive environment for indigenous (and foreign) private sector. This will ensure that a part of private sector income, which otherwise would not have been mobilized by the State through taxation or by the financial system through non-securities markets, could find its way into productive investments. As the Bank study shows, the bulk of measurable savings in Africa appears to have been contributed by the private sector. Thus, given appropriate micro-and macro-economic policy framework, attractive investment opportunities and other facilities, encouragement of the private sector could greatly facilitate the mobilization of domestic and foreign savings.

As alluded to above, the securities capital markets can be very efficient mechanisms for mobilization and allocation of scarce financial resources and one condition for the development of viable capital markets is the existence of a large indigenous modern private sector willing to issue securities. Thus, the role of the financial and non-financial private sector in domestic resource mobilization and allocation into productive investments can be crucial in facilitating economic recovery and development in Africa as has happened in Asia and Latin America. The greater role of the financial private sector is discussed in greater detail in section 5 of this paper.

15/ ADB, Domestic Resource Mobilization, op. cit. and also ADB/ECA Economic Report on Africa, 1987, op. cit. p. 49.

4.3 Perspectives on external finance

Over the period 1970-1985, the resources gap (saving minus investment) has been widening for 42 out of 50 African countries. 17/ In the light of the fact that external concessional financing environment has also been deteriorating, non-concessional (including variable interest rate) finance has been resorted to. The result has been an acute debt-servicing problem which has become a major constraint on recovery and development in the continent. Yet, external resources will, for a very long time, remain a crucial input in the development of Africa, provided two basic conditions are met.

First, investment projects or programmes financed with borrowed resources must be carefully selected and prepared; and the return on projects and programmes which generate foreign exchange must be greater than the cost of external loans contracted by the country. Second, the external environment (that is interest rates, African export prices and access to industrial country markets) has to remain favourable. Domestic environment for effective use of external loans is being created. However, it cannot be assumed that the external environment would change favourably in the near future, particularly with respect to the possibilities of export expansion. For instance, during the nineteenth century, a 1 per cent growth rate in incomes in GNP of industrialized countries induced a 1 per cent growth in primary commodity exports of LDCs, whereas at present, a 1 per cent growth in GNP of industrial countries leads to an increase in exports of LDCs of 0.5 to 0.6 per cent. 18/ These developments mean that the capacity of present primary commodity producers to increase their exports in order to service external debts is much less than what it was in the nineteenth century.

Thus, just as African countries are largely responsible for the removal of domestic constraints, the international community, particularly the donors, also has a primary responsibility for eliminating or at least reducing external constraints on African recovery and development. The primary objective by African Heads of State and Government of taking their case to the United Nations General Assembly special session was not so much as to inform the international community about the measures they were taking but to request the donor community to play a positive role in promoting mutual international co-operation. The inaccessibility to developed country markets, depressed commodity prices, stagnation in the inflow of concessional resources, high real interest rates and decline in the net resource transfer are all beyond the control of African countries. As pointed out above, these external constraints have eroded the African capacity to service their external loans, let alone to achieve economic recovery and development. The commitment by the international community, however, to:

17/ ADF, Proposal for the Fourth Replenishment of Resources (Abidjan, November 1983), p.9.

18/ Rosenstein-Rodan, P.N., "Philosophy of International Investment in the Second Half of the Twentieth Century", In (Eds) J.H. Adler and P.W. Kuznets, Capital Movements and Economic Development, (London, 1967), Ch.4. Current studies still show that the "trickle" down effects will continue to be weak until perhaps greater product diversification is achieved in present-day developing primary commodity exporters.

> "Making every effort to provide sufficient resources to support and supplement the African development effort", 19/

is clearly a necessary first step. However, a sufficient next step is to ensure a strong and positive net transfer of concessional resources to Africa and in particular to ease the trade constraint in order to effectively support adjustment measures and policy reforms underway in the continent. Yet, concessional lending to sub-Saharan Africa as a share of total bilateral flows has declined from 84 per cent in 1975 to 62 per cent in 1985. 20/

In this connection, the donor community needs to view concessional aid in its proper perspective. 21/ First, when highly concessional finance is given, it is always accompanied by close supervision, unlike commercial finance. Thus, donors have a leverage to ensure more efficient use of aid for the benefit of all parties. Second, the "transfer burden" on African countries is clearly positive and heavy because these countries are unable to raise prices of their exports in order to meet higher debt service payments. Third, in Africa, what is needed is structural transformation (as endorsed by UN-PAAERD) of the economies and given the slow nature of the process, concessional aid is clearly crucial. Fourth, as already pointed out above, technology, capital goods imports, skilled manpower and raw materials are much more expensive today than they were during the nineteenth century. Thus, substantial inflows of concessional resources is an absolute necessity if UN-PAAERD is to be effectively implemented.

5. THE ROLE OF DEVELOPMENT AND OTHER FINANCE INSTITUTIONS IN ECONOMIC RECOVERY AND DEVELOPMENT

When discussing domestic constraints on development above, mention of institutional factors was made and for the rest of this paper, the role of development institutions, particularly financing organizations in Africa will be examined. The history of development also shows that in economically backward countries development institutions were created by Governments to fill specific gaps in the development process. It was believed that such deliberate action would accelerate development so as to catch up with other fast developing countries. 22/ In other words, missing ingredients in the development process were substituted by other factors which could be provided

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19/ UN-PAAERD, op.cit., paragraph 16.

20/ Lancaster, C. and Williamson J. (Eds) African Debt and Financing (Washington D.C., Institute for International Economics, May 1986) Special Reports No. 5., p. 34.

21/ See Streeten, P., "Why Concessional Aid?" International Journal of Development Banking, vol.2, no.1., January 1984, pp. 5-9 for a more detailed analysis of the case for concessional aid.

22/ Gerschenkron, A., Economic Backwardness in Historical Perspective (Cambridge, Mass., 1966) by the State.23/ However, the mere filling of observed gaps by creating development institutions was not adequate to accelerate development. This was particularly so in time of economic crises and in countries characterized by high levels of non-monetized output, wide preference for holding wealth in form of real assets, dormant entrepreneurial activity, undeveloped human resources, etc. What was required, it was argued by Patrick,24/ was for financial institutions not only to satisfy emerging demand but to actively seek demand for their services in a "supply-leading" manner. Given such a behaviour and a conducive macro-economic policy environment, financial intermediation was expected to explain a large part of the growth in savings, entrepreneurship and in gross domestic product. At least, a high and positive correlation is expected to exist between these variables.

In the African case, a whole range of financial institutions were created at independence to fill specific gaps. At the continental, subregional and national levels, development banks or corporations were established to mobilize and seek productive investments of the resources. In the light of these actions, what has been the record of performance? The limited literature available on the study of the role of financial institutions in African development indicates little discernible relationship between financial intermediation and economic development or growth. 25/ More recent evidence seems to show the limited capacity of financial institutions in Africa to mobilize domestic resources particularly in the rural areas. 26/ Obviously, more rigorous research using more recent data is required. However, it appears that the institutions created in Africa have largely behaved in a responsive and uninnovative manner, uninfluenced by the supply-leading or active behaviour theory as was the case in Asia, particularly South Asia.

At the present time when economic deterioration has been taking place, financial institutions cannot afford to wait for demand for their services. This does not mean that demand for their services is totally absent. However, for the purpose of reversing the economic decline, what should be generated is effective demand for finance and promotional services. This means that these institutions have to re-orient their operations, actively mobilize resources, identify projects or programmes, prepare them and, at times, participate in their execution. Entrepreneurship, skilled manpower and management have to be activated from their dormant state. Research into new methods and technologies needs to be intensified. As close as they are to governments, national development finance institutions need to be involved in economic policy analysis, formulation and implementation. In short, innovative behaviour in all these areas has become imperative, if development finance institutions are to justify their existence in countries facing economic collapse.

23/ Gerschenkron, op. cit.

24/ Partick, H.T. "Financial Development and Economic Growth in Under-developed countries", Economic Development and Cultural Change, vol. 14, No. 2, 1966, pp. 174-198.

25/ Bhatia, R.J. and Khatkhate D.R., "Financial Intermediation, Savings Mobilization, and Entrepreneurship Development: The African Experience", IMF Staff Papers, vol. 22, no. 1, (March 1975), pp. 132-158.

26/ ADB, Domestic Resource Mobilization, op. cit.

At the continental level, how has the African Development Bank (ADB), the only such institution at this level, responded to the challenge facing Africa? The answer lies in an important policy statement by the President of the Bank, immediately after attending the OAU Summit at which APPER was adopted. The Bank was to be seen not just as a development financing institution but more than that:

> "Our Bank should rise to this challenge, re-examine conventional approaches and techniques, generate new ideas and methods and, in the process, transform itself into a new Bank, more responsive to the times, forward-looking, imaginative and effective". 27/

The first concrete measure in the new re-orientation of the Bank relates to the size of resource mobilization. Given the magnitude of the resources required to implement APPER, the management of the Bank has requested a 200 per cent increase in the capital resources of the Bank, and approval has been given in principle. When this is combined with a matching increase in the resources of its soft-loan affiliate - the African Development Fund (ADF) and co-financing, the Bank Group is expected to lend at a rate of about $2.3 billion per year during the next five years. The significance of the role of the Bank Group in economic recovery and development of Africa cannot, therefore, be overstated. However, to achieve this objective, new methods of lending are imperative. In this connection, the ADB Group has already introduced non-project lending which is most appropriate for the needed structural transformation of African economies. 28/ To cope with this type of lending, economic policy analysis and continuous dialogue with member countries will be required. Towards this end, the Bank has recently restructured its services and is increasing its relevant staff.

It must be pointed out, however, that the traditional project-lending approach will continue to dominate the Bank's operations but it is placing new emphasis on projects and programmes which either generate or save foreign exchange, with concentration on agriculture and supportive sector activities. Other than making foreign exchange available for essential imports and external debt servicing, an expansion in exports, both traditional and non-traditional, would considerably enhance the potential of regional member countries to mobilize domestic resources. Expansion in export production, however, would need to be supported by export financing - a facility the Bank is seriously considering. Lack of export credits at lower cost, among other factors, has placed African exporters at a disadvantage, at a time of critical shortage of foreign exchange. Therefore, this new activity by the Bank could greatly assist member countries in expanding their exports.

27/ N'Diaye B., Speech on the occasion of his investiture as President of African Development Bank Group, Abidjan, 31 August 1985.

28/ ADB, A Proposal for the Fourth General Increase in the Bank's Capital, Document ADB/IC - IV/86/02 (Abidjan, April 1986).

Other than the Bank's contribution through the above operations, indirect contribution can also be made in the area of domestic resource mobilization through a variety of channels. In this connection, it needs to be stressed that mobilization of domestic savings takes different approaches, depending on the net benefits attached to the techniques by the country concerned. 29/ In some economies, the fiscal technique is the main vehicle for mobilizing surpluses. As the study at the Bank referred to above suggests, taxation in these countries needs to be examined and rationalized and the Bank may wish to provide advice in this area within the context of policy-based lending.

However, in other economies, cost-benefit analysis may indicate that domestic resources would most efficiently by mobilized through capital markets (both securities and non-securities markets). In this area, the Bank's role is not entirely new. Traditionally, the Bank has been involved in promoting development and other finance institutions in Africa through equity participation, lines of credit and support of the Association of African Development Finance Institutions. But more could be done in this area by way of innovation.

For instance, the Bank could study the possibility of promoting what are called Development Savings Banks, which combine the features of Provident Funds (compulsory accumulation of savings by the money income earning population, including farmers) and those of Unit Trusts (means of providing investment opportunities for the average person). 30/ The ultimate goal of such institutions is equitable distribution of wealth and incomes, greater domestic resource mobilization and an increase in personal savings going into equity investments. 31/

More life insurance and pension financial institutions could also be promoted as was the case with Africa Re-insurance. Life and pension premium incomes have proven to be very important sources of long-term domestic savings. Yet in most African countries, such premiums constitute a small proportion of insurance company income.

In connection with promotion of financial institutions, the Bank has some innovative role to play in the development of capital markets, particularly securities markets. 32/ The latter institutions play a critical role in mobilizing foreign and domestic savings and channelling them into productive investment. The fact that only a handful of securities markets exist in Africa

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29/ Gurley, J.G., "Financial Structures in Developing Economies", in Krivine, D. (ed.), Fiscal and Monetary Problems in Developing States: Proceedings of the Third Rehovoth Conference, (N.Y., Praeger Publishers, 1967), Chapter 6.

30/ Loganathan, C., Development Savings Banks and the Third World - A Tool for the Diffusion of Economic Power (London, Praeger Publishers, 1973) provides detailed features of this model for domestic resource mobilization.

31/ Loganathan, ibid., p.39.

32/ As stated in A Proposal for the Fourth General Capital Increase in the Bank's Capital, op. cit., p.3.

poses a great challenge to the Bank Group. It would, therefore, have to be more active in promoting the development of capital market institutions through, among others, direct equity participation in and lending to medium- and large-scale private enterprises, through the IFC type of mechanism. For without a viable private industrial sector, the supply of securities is bound to be limited, and evidence shows that this is one of the main reasons for failure of capital markets. Technical assistance and advice to member countries on approaches to the development of capital markets and the private sector would be necessary. The Bank would have, first, to commission a study and hold seminars for regional member countries on the development of capital markets. 33/ The Bank study on domestic resource mobilization cited above is clearly a step in the right direction. As with new forms of lending being introduced, to be able to assist in this new areas, appropriate staff would have to be developed.

There are other new areas of support the Bank is actively studying. Among these is direct support (through an IFC type of institution) for the growth of the private sector, as alluded to above, which is essential for the growth of capital markets and enhancement of the potential for effective domestic resource mobilization. It is commendable that a Division within the Bank has been created for the purpose of promoting the private sector in countries requesting such assistance. Towards the same goal, the participation by the Bank, IFC and UNDP in the African Project Development Facility, the aim of which is to assist African entrepreneurs to identify and prepare viable projects and to assist them in seeking financing, is a clear testimony of the active and innovative behaviour on the part of these three development institutions. Such a behaviour is indispensable under the current economic crisis in Africa.

6. SUMMARY AND CONCLUSIONS

In summary, this paper commenced with a review of development strategies, between 1960 and 1970, which emphasized the role of capital (foreign and domestic) in propelling the economy. It was shown that, indeed, growth was accompanied by inflows of foreign capital to supplement domestic savings. However, the paper showed that the growth momentum that was building up in the 1960s was not sustained in Africa during the 1970s and early 1980s, while Asia and Latin America continued to register positive growth rates in food production and GDP per capita. The broad explanation suggested for these divergent growth rates was that Africa may have paid less attention than was done in other regions to the removal of domestic structural constraints and institutional weaknesses. Where these impediments had been removed, the economies continued to grow in the face of, or at least, were resilient to the unfavourable external shocks.

The appropriateness of the agriculture-oriented strategy and policy reforms in APPER for Africa's economic recovery and development was acknowledged in the paper but a warning of the danger of ignoring strategies in other sectors unrelated to agriculture was sounded. Due to the changed economic circumstances

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33/ The Asian Development Bank has already commenced along these lines. See ADB, Capital Market Development, (Manila, 1985).

with respect to the unit cost of inputs and the goal of achieving growth rates of the 1970s, it was argued that the resource requirements estimated for APPER's implementation appear to be on the low side. The suggested order of magnitude of resource requirements imply a greater effort in mobilizing resources than was envisaged. Yet, the potential for domestic savings mobilization was observed to be deteriorating. The paper suggested that extraordinary and innovative measures had to be taken to mobilize the required domestic resources. A special APPER tax of 5 per cent on annual private consumption was suggested and was estimated to yield about 40 to 62 per cent of the domestic component of resources required.

Although the arguments in the paper endorsed the commitment by African countries to raise the bulk of resources required domestically, the need for increased concessional resource flows to Africa was emphasized. In particular, the paper saw the removal of external constraints on expansion of African exports as a basis for lasting solutions to the current external debt-servicing problems and as a solid foundation for sustained economic recovery and development.

Finally, it has been argued that the existence of development and other finance institutions alone is not adequate to promote economic recovery and development. Indeed, the literature briefly reviewed indicated that the contribution of financial intermediaries to growth in Africa appears to be insignificant. It was suggested, therefore, that these institutions have to adopt innovative and active behaviour if their role in promoting recovery and development were to be meaningful.

The paper observed that the African Development Bank Group was showing signs of active behaviour through a substantial increase in its lending programme and promotional services. However, more still has to be done in the area of promotion of domestic resource mobilization through support, for instance, of savings banks and development of capital markets in regional member countres.

<u>In conclusion</u>, the strategy of focusing attention on the removal of internal or domestic constraints or rigidities as contained in APPER can only be regarded as the most important sign of hope that, in future, continental financing will play its full role in promoting economic recovery and development in Africa. However, development and other financial institutions would need to re-orient their operations in order to cope with the demands on them to finance projects and programmes for speedy economic recovery and development. Further, the external environment (increased concessional capital flows and greater access of African exports) would need to be much more favourable in support of actions at the domestic level.