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Research Report

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Aid – Dinosaur or Development Engine for Sub-Saharan Africa?

Summary

The situation of the 49 countries of sub-Saharan Africa has become even more varied in the past few years. The changes are highly relevant to aid (official development assistance / ODA) and other forms of development financing. The question is what contribution aid can make in the future in an environment undergoing such manifest change. The following structural changes are currently taking place:

- (1) By and large, sub-Saharan Africa's economic situation has developed positively in the past twenty years, not least because the various countries have pursued better policies. While the majority were characterised in the 1990s by enormous budget deficits, high rates of inflation, government intervention, capital flight and black markets, the countries of the region generally have more room for manoeuvre today, not least with regard to their own budgets. In the last decade a group of some 10 to 20 countries in the region managed to achieve significant growth rates; the international financial and economic crisis did little to alter this. At the same time, there are still a number of countries where economic dynamism is still unsatisfactory or where, despite growth, there has been less than adequate improvement in living conditions.
- (2) The quality of governance has improved in sub-Saharan Africa as a whole. Public financial management is, on average, better today than it was in the past. Nonetheless, clientelist and neo-patrimonial systems, which have considerable influence on the

use of resources, continue to leave their mark in many countries. Reforms aimed at improving the political environment (political openness, etc.) have yet to be undertaken in many countries of the region.

- (3) International financial flows to sub-Saharan Africa have grown sixfold since 2000. This steep rise has been accompanied by major changes to financial structures, the proportion of private inflows having increased significantly. Aid continues to play an important role, although the scene is increasingly dominated by foreign direct investment and foreign workers' remittances. Such "new cooperation partners" as China, India and Arab countries are also triggering major changes; the importance of South-South relations for sub-Saharan Africa is growing.
- (4) For oil-exporting countries in particular and for the middle-income countries aid has already become far less important. In the low-income countries and the fragile states, on the other hand, it often continues to play a major role, although even poor countries have stepped up their efforts to become less dependent on it. In fragile countries it frequently plays the role of counteracting state disintegration.

Given the dynamic developments in sub-Saharan Africa, it is very important to know precisely what effects internal and external resources have on development processes. A better understanding of relevant internal and external resources and policies will be vital for development research in the coming years.

The environment in which aid (official development assistance), like other external policies, and internal actors operate in sub-Saharan Africa is changing rapidly and fundamentally. The following analysis outlines the subject from three angles: (1) groups of countries in the region and their changed views of or need for development financing, (2) important new trends in economic requirements and governance conditions and (3) the structure of development financing in sub-Saharan Africa.

Country differentiation

In the last two decades the countries of sub-Saharan Africa have undergone processes of change at different speeds and, to some extent, in different directions. Existing country classifications have only just begun to find appropriate categories for the current process of differentiation. With the aid of the IMF (International Monetary Fund) classifications a rough description will be given here of the development financing features of four groups (by which a few countries of the region are not covered):

Oil-exporting countries (seven countries with a total population of about 214 million): The oil-exporting countries (i.e. countries where oil accounts for more than 30 percent of the value of total exports) of sub-Saharan Africa have resources that enable them to make substantial investments of their own; a number of other countries heavily dependent on mineral exports have generally similar features. The main challenge – faced by Equatorial Guinea, for instance – is how to manage the available resources. The risk of their not being invested in longer-term development processes, but consumed, and of clientelist structures being promoted tends to be high. The need for finance through and dependence on aid are limited in this group of countries (Nigeria and Angola, for example, depend on ODA for only about half a percentage point of their economic strength), although donors sometimes use aid in pursuit of their own economic interests in these countries. Even the prospect of future oil revenues – see the examples of Ghana and Nigeria – leads to a significant decline in the importance and influence of aid.

Middle-income countries (eleven countries with a total population of some 105 million): Characteristic of this group is the relatively pronounced importance of foreign direct investment (FDI) for the manufacturing sectors. This investment is less susceptible to the manifestations of international crises, since it is of a long-term nature and tends to be focused on the development of value chains. The countries themselves – Mauritius, South Africa and Botswana, for example – are very interested in investing their own money in human capital and in pursuing strategies that promote the private sector. Overall, this group of countries is interested in FDI. The influence of aid is, for the most part, on the wane and insignificant.

Low-income countries (14 countries with a total population of about 342 million): These countries (e.g. Ethiopia and Tanzania) are still heavily dependent on aid, with the focus on longer-term poverty alleviation objectives. A large proportion

of public investment is dependent on external assistance. The private sectors of some countries in this group are developing dynamically, though often from a low starting level. Some countries may join the middle-income group in the medium term. Given sometimes low domestic revenue and the current challenges (posed, for example, by energy and transport infrastructure), the financial requirements of this group are high. On the whole, aid is often the dominant source of external financing, but this dependence may be progressively reduced by a relatively dynamic private sector and foreign investment.

Fragile countries (twelve countries with a total population of around 138 million): This group is heavily dependent on aid. The countries in the group (such as Burundi and the Democratic Republic of Congo) are characterised by governance challenges and low reform capacities, because political instability and clientelist structures often dominate. The risk associated with public investment financed from internal revenues and aid is that it will not be effective. ODA often contributes to stabilisation, the aim being to counteract signs of state disintegration. What private investors there are are largely to be found in the exploitation of minerals and other natural resources rather than sectors with a long-term future. The revenue generated from those activities is frequently unavailable for development processes. On the whole, aid and, to some extent, humanitarian assistance are extremely important for the functioning of these countries and for the provision of a minimum of public services.

A question arising for aid, especially in countries where dependence on it is limited and continuing to decline, is whether prolonged involvement still makes sense in development policy terms. In the debate the advocates of aid geared to “poor countries” tend to be opposed by the advocates of approaches in which there are seen to be equally worthwhile tasks in dynamic and advanced countries (e.g. catalysing private inflows).

Economic and political trends

Economic trends: Sub-Saharan Africa’s general economic strength has grown since the 1990s. Nonetheless, major differences among the sub-Saharan African countries and disparities in individual countries – such as South Africa – persist. The question of the quality of growth is also relevant, since a structural development process is not necessarily accompanied by an economic boom. In resource-rich countries (such as the oil-exporters), for instance, management is often inadequate (serious corruption, insufficient long-term investment, etc.). On average, the African economies remain volatile, economic diversification having yet to take place in many cases. On the other hand, a group of relatively successful economies has emerged in the past 10 years or so. The IMF refers to a total of eleven countries in the region with comparatively high growth potential (frontier markets), but there are still significant differences from, say, Asian growth countries. At the same time, there continues to be a group of countries that are hardly integrated into the world economy at all; this is true of about a third of the countries in the region.

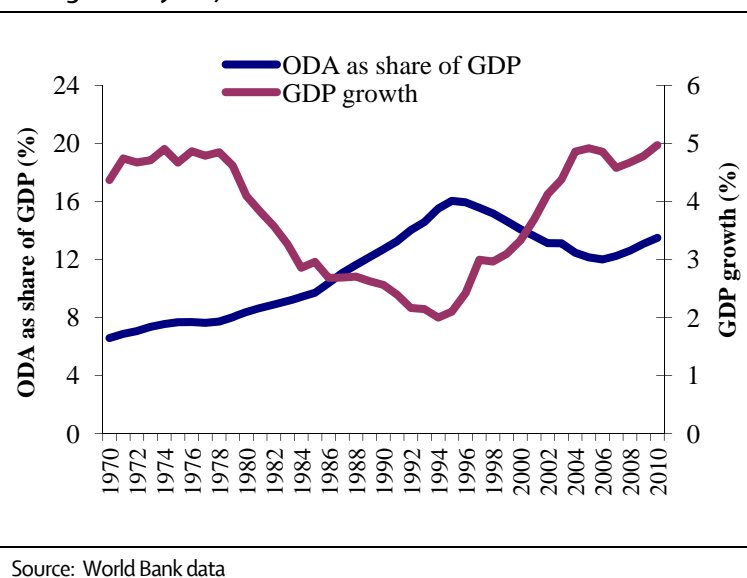
The development of sub-Saharan Africa's macroeconomic situation has largely been positive, not least because its countries have pursued better policies. In the early 1990s most African countries were *de facto* bankrupt, with rapidly growing debts. The majority were afflicted with enormous budget deficits, two-digit rates of inflation in many cases, government intervention, capital flight and black markets. Foreign indebtedness is therefore the clearest indication of the new environment. Of the 33 African countries that qualified for the Heavily Indebted Poor Countries (HIPC) initiative, 29 have meanwhile reached at least the first stage of debt relief. Today the countries of sub-Saharan Africa have to spend, on average, less than 5 percent of their export revenues on debt servicing. In 1995 the figure was, at 16 percent, significantly higher. Consequently, African countries now enjoy more leeway in the framing of public budgets than in the past. This has enabled governments to be more creative in the policies they pursue (on investment and reform programmes, for example) and given countries greater responsibility for their own destinies. With their own revenues averaging around 18 percent of GDP, sub-Saharan African countries are themselves earning a substantial proportion of their expenditure on development financing.

Governance trends: In many respects, the quality of governance in the countries of the region has a major influence on financial inflows. This is true of both private and public inflows, whether the aim is to attract private investors or aid resources. On the whole, political governance has improved in the last twenty years. Together with Europe's countries in transition, sub-Saharan Africa, seen from a global perspective, has made most progress. This does not mean, however, that individual countries have not faltered from time to time (as a comparison of annual figures, in the Mo Ibrahim Index, for example shows). In many of the region's countries reforms aimed at improving the political environment (above all, democratisation) are still to be undertaken.

In the case of economic governance sub-Saharan Africa lags well behind all other regions of the world. The *Doing Business* international ranking (2011) shows it taking, on average, 137th place out of a total of 183, indicating a serious need for reforms. However, a comparison over time reveals gradual average improvements in the region.

Public financial management (PFM) is a core dimension of governance. It covers not only the administration of public finances but also budgetary institutions and procedures, such as parliamentary budget committees, independent audit offices and budgetary planning. PFM reforms seek to make the handling of government revenue and expenditure more transparent, more effective and more efficient. Improved analytical instruments now make for suitable approaches to measuring the performance of public financial management.

ODA as share of GDP and growth rates in sub-Saharan Africa (moving average for 10 years)



Source: World Bank data

In this context, it is possible to identify a number of countries (such as Rwanda and Mauritius) which have established far more efficient PFM systems than they had in the past. Nonetheless, clientelist and neo-patrimonial systems continue to dominate in many countries.

Change in development financing

International financial flows to sub-Saharan Africa grew sixfold in the last decade (2000-2009). This sharp rise was joined by a major structural change, the private inflow share increasing significantly.

External financial inflows can be divided into two categories: (i) public financial inflows, which, in sub-Saharan Africa's case, include in particular resources for aid (ODA), which may take different forms (financial and technical assistance); but, as a general rule, they also include other official resources (export credits, for instance). The absolute volume of aid has continued to grow since 2000. Currently, sub-Saharan Africa receives about USD 44 billion (2010, net) each year, its 30 percent share of total OECD ODA being relatively stable.

Precisely how much aid contributes to growth continues to be disputed among researchers. It is not clear from research findings whether aid can be proved to promote growth or such proof is impossible. Average dependence on aid in the region (in terms of its share of GDP) has declined in recent years, particularly because of improved economic performance (see diagram). Public inflows other than development cooperation (such as export credits) have so far been largely insignificant. The OECD countries' efforts are increasingly joined by cooperation between "new donors" (including China, India, Brazil and the Gulf States) and sub-Saharan Africa. As regards the scale of this cooperation, it is assumed that China's development cooperation with the region, for example, is still roughly equivalent in volume to that of a medium-sized traditional donor (such as the Netherlands), but as it differs in nature

(more extensive mix with other forms of cooperation, etc.), it stands only limited comparison with that of traditional donors.

(ii) Private financial inflows: These include FDI and short-term capital flows (portfolio investments) and remittances by migrants to their home countries. Although subject to sometimes major fluctuations, FDI and portfolio investments amounted to almost USD 30 billion (FDI: USD 33.6 billion; portfolio investments USD -4.2 billion) net in 2011. In sub-Saharan Africa a heavy concentration on just a few countries is to be observed, around two thirds of all investment going to South Africa, Nigeria and Angola; equally large is the share of investment in oil production and mining. Officially recorded remittances from migrants to sub-Saharan Africa are rising sharply, having amounted to USD 20.8 billion in 2009.

Two other aspects are relevant to private inflows. First, foreign investment by African investors is playing a growing role. A leading actor in this respect is South Africa, which is active primarily in southern Africa. Second, regional integration is a relevant dimension. In some regions gradual progress is being made in this regard, this being true, for instance, of the Southern African Development Community (SADC) in southern Africa and of the East African Community (EAC) in the East African region. Economic communities are particularly important pull factors for foreign investors who are not involved in the oil and minerals sector.

Conclusions

The situation of the countries of sub-Saharan Africa has become even more varied in the past few years. Some have

resources of their own to finance development, which is very important for development processes; external development financing similarly continues to be vital for most of the countries, and the group for which private inflows play a major role is growing. Development cooperation often performs an essential function not only, but above all, in the low-income countries and fragile states. Such low-income countries as Liberia and Rwanda are making growing efforts to escape their long dependence on aid.

The dynamic developments in sub-Saharan Africa enable various important topics to be singled out for closer consideration and discussion in the coming years:

- (i) Little is known of the role played by internal and external resources in development processes or of precisely what effects they have. It would therefore be wise to focus research more specifically on successful development patterns and the role of different approaches to development financing.
- (ii) As development financing patterns are becoming more complex (public and private financial flows, new actors, differentiation of modalities), a deeper understanding of the effects on and benefits to development of different approaches is needed.
- (iii) Against this background, the options open to aid to promote development processes relevant in various country contexts should be considered and, if necessary, adjusted.



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