

Report of the Commission for Africa (RCA): Comments

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General Areas of Agreement with the RCA

- That G-8 countries must help SSA to attain a higher rate of economic growth and reduce poverty. It is a noble goal and what the RCA calls a moral duty.
- That developed country protection has to be quickly eliminated.
- That Africa's growth and trade problems are mostly supply side related rather than demand side related.
- That solutions and approaches have to be homegrown; SSA countries must take ownership of a program to raise growth.
- Towards that end, the New Partnership for African Development (NEPAD) and the Peer Review Mechanism (PRM) can design, implement and monitor a wide program of reform with help from outside assistance but with African nationals taking the driving seat.

Areas for Discussion

- Having agreed with the above propositions, the question then is: *does the approach taken and the recommendations made in the RCA help SSA to reach these goals ?*
- We discuss this question with respect to: (a) the relationships among aid, investment and growth in SSA (b) the approach and proposals for trade made in the RCA.
- We look at empirical evidence and use economic analysis to answer this question.

Aid-Investment-Growth Nexus: *The Analysis*

- What the RCA has taken for granted for this nexus does not have a good history. These are some central findings of empirical work on the issue:
- (a) Aid does not necessarily finance investment (Burnside and Dollar 1997).
- (b) Investment does not necessarily lead to growth (Dollar and Easterly 1999).
- (c) Investment has not been a major constraint to growth in SSA. (Devarajan, Easterly and Pack 2003).
- Most of these studies show that *public investment* had no effect on growth or had a negative effect on growth when it crowded out private investment. Private investment is endogenous and takes place when growth has begun with good policies in place.
- Aid works when it is well-designed and extended in modest amounts in good economic policy environments. Conversely, badly designed, large amounts of aid have led to the debt crisis and the need for debt forgiveness. Such aid left people more impoverished than before (Nigeria, Gabon and Zambia are examples).

Aid-Investment-Growth Nexus:

The Evidence

- There are other factors that have broken the nexus among aid, investment and growth in SSA when there is civil strife arising from ethnic fractionalization, bad neighborhood effects and authoritarian Governments that have agreed to aid conditionality when they have had no intention of implementing a program of reform. This happens when the Government is not accountable to the people.
- Many have emphasized the importance of institutions that can carry through a reform program (Easterly and Levine 2002). The difficulty is that it takes time to build transparent institutions that are responsive to the demands of the population, which is a hallmark of democratic societies.
- Some African countries have been successful in raising GDP growth and sustaining it, thereby reducing poverty to an appreciable degree even given daunting initial conditions. They are Botswana, Mauritius and more recently Uganda.
- A group of new leaders have emerged that also provide hope beyond the history and the analytics led by the likes of Mandela and Musaveni to name a couple.

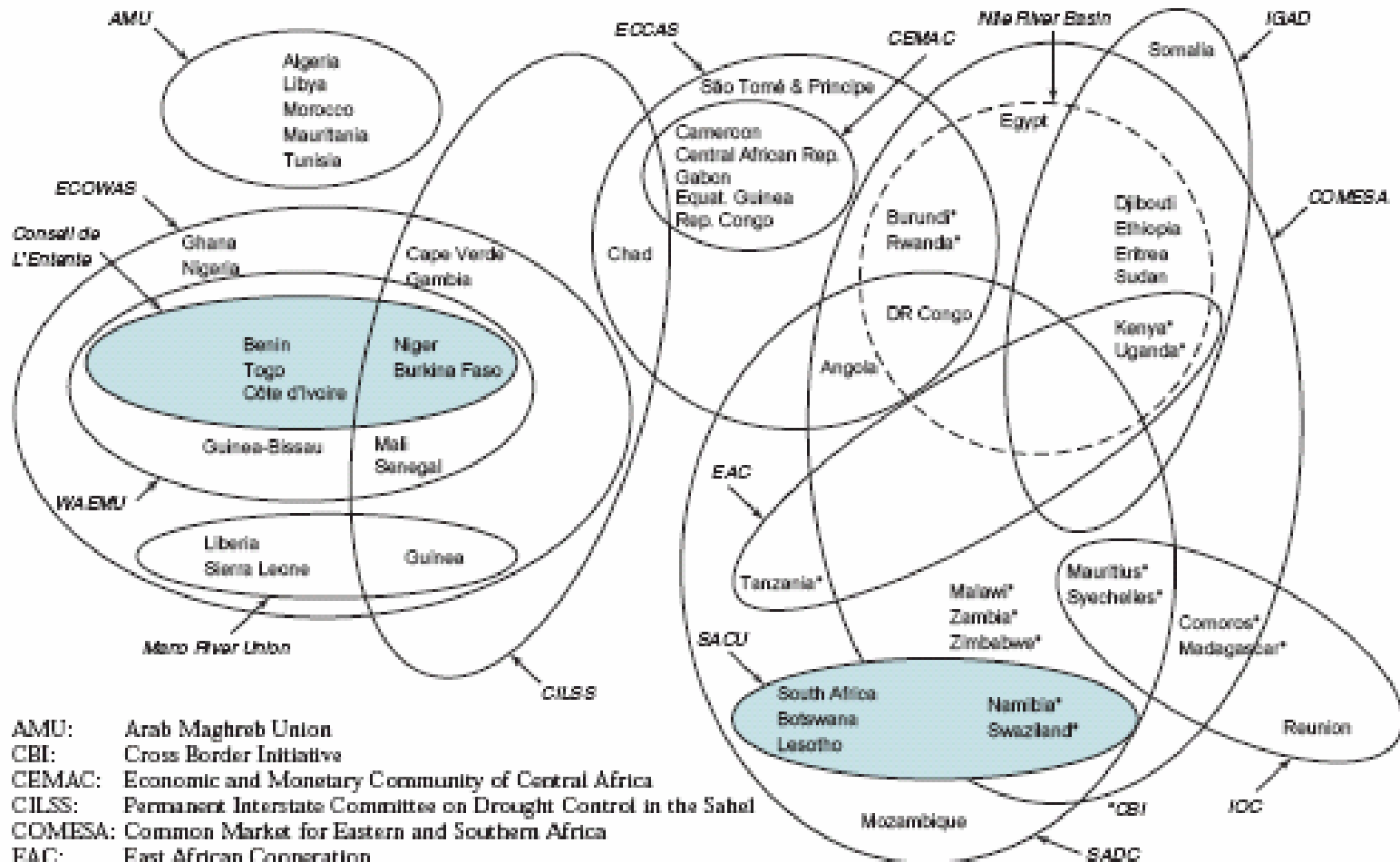
Approaches and Recommendations on Trade in the RCA

- The main challenge for SSA is to make trade a vehicle to achieve higher efficiency and growth.
- SSA should pursue a policy of liberalization and protection.
- It emphasizes regional trading arrangements and preferential trading arrangements with developed countries, but with light rules of origin.
- It recommends targeting certain commodity groups for export to support poverty reduction through the trade instrument directly.
- It claims that exchange rate appreciation that could be caused by large aid flows can be dealt with by greater imports.
- It holds that SSA should continue to receive special and differential treatment given its low level of development based on Part IV of GATT of 1979.

Comments on Trade issues in RCA

- Many of these recommendations have a poor history and scant analytical basis.
- First, in deciding to fine-tune the protection structure, RCA may encourage capture of the tariff making process by special interest groups.
- Regional trading arrangements bring with them a host of problems that can lead to net trade diversion and can hinder growth (Bhagwati and Panagariya 1996).
- Rules of origin are the other side of the coin of preferential agreements, and they operate as non-tariff barriers (Krueger 1993).
- Pre-selecting export activities to directly support poverty reduction may not work in practice given that the problems are largely due to poor incentives and weak trade facilitation so that the farmers receive only a small return for their value adding process. It is equivalent to picking winners.
- Exchange rate appreciation is inevitable with aid inflows due to the manner in which external resources are absorbed. Relying on imports alone does not help when part of the aid financed expenditure is spent on non-tradable goods as it must. E.g. when infrastructure expenditure is increased, the demand for non-tradable goods will rise.
- Special and differential treatment leads to a situation where countries remain poor because they look for departures from MFN status, and that leads to a self-fulfilling prophecy of countries remaining poor because they are not prepared to bite the bullet and enter world competition. Trade preferences are not a good way to help these countries.
- The approach and recommendations on trade in the RCA indicate a backward step for SSA. The region must begin to compete on an equal footing in the world market if it is to rise from poverty. The RCA recommendations are weak and often contradictory.

African Regional Trade Agreements: The Spaghetti Bowl



- AMU: Arab Maghreb Union
- CBI: Cross Border Initiative
- CEMAC: Economic and Monetary Community of Central Africa
- CILSS: Permanent Interstate Committee on Drought Control in the Sahel
- COMESA: Common Market for Eastern and Southern Africa
- EAC: East African Cooperation
- ECOWAS: Economic Community of West African Studies
- IGAD: Inter-Governmental Authority for Government
- IOC: Indian Ocean Commission
- SACU: Southern African Customs Union

- SADC: Southern African Development Community
- WAEMU: West African Economic and Monetary Union
- * Indicates membership in CBI regional grouping

Source: Schiff and Winters 2003.

A Modest Proposal

- For the reasons given here on both the aid-investment-growth nexus and trade, it would be best to adjust aid flows to a level at which they can be absorbed, implemented and monitored in worthwhile projects, rather than aim to double aid flows to Africa over the next three to five years and then raise them by an additional \$25 billion in the following five years.
- Undertake well-designed reforms based on proper identification of constraints on the supply side and have them reviewed at Development Forums that would include not only PRM members but donors.
- Provide grants to finance these well-designed programs, noting that what aid can achieve will be modest.
- Avoid the penchant for regional integration and preferential arrangements -- they lead to more problems than achievements and create non-trade barriers in the form of rules of origin.
- Use the Millennium Challenge Account model to support SSA, based on homegrown programs in which funding is related to *performance* and not *carte blanche*.
- Create sufficient headroom and incentives for the private sector whose absence has been conspicuous in most parts of SSA save for few countries like Botswana, Mauritius and Uganda. That speaks reams to why SSA has found itself in the present predicament. This needs to be reversed.