UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

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RECLAIMING POLICY SPACE
Domestic Resource Mobilization and Developmental States

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UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT
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EXPLANATORY NOTES

The $ sign refers to the United States dollar.

Sub-Saharan Africa (SSA): Except where otherwise stated, this includes South Africa.

North Africa: Unlike in the UNCTAD *Handbook of Statistics*, in this publication Sudan is classified as part of sub-Saharan Africa, not North Africa.

ABBREVIATIONS

APRM	African Peer Review Mechanism
FDI	foreign direct investment
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
GERD	gross expenditure on research and development
GNI	gross national income
ICT	information and communication technology
IMF	International Monetary Fund
ISI	import substituting industrialization
MDGs	Millennium Development Goals
NEPAD	New Partnership for Africa's Development
NIEs	newly industrializing economies
ODA	official development assistance
OECD	Organization for Economic Cooperation and Development
REI	rigidity of employment index
SAP	structural adjustment programme
WTO	World Trade Organization

Introduction

One of the most prominent objectives of the Millennium Development Goals (MDGs) adopted at the United Nations Millennium Summit in 2000 was to have member States halve their levels of absolute poverty by 2015. While some regions of the developing world have made sufficient progress towards achieving this goal, sub-Saharan Africa has been singled out as one region that is unlikely to meet the target by 2015 if current trends continue. Indeed, halfway through to the target year, the latest data on poverty shows that sub-Saharan Africa is the only developing region where the absolute number of poor people has been steadily increasing, even if the relative number declined from 47 per cent to 41 per cent of the total population between 1999 and 2004 (Chen and Ravaillon, 2007). One of the reasons why sub-Saharan Africa might miss the 2015 target is its relatively low rate of economic growth. Indeed, despite the recent gains made by a number of countries in terms of export revenue, thanks to high prices of some major primary commodities, the growth rate in sub-Saharan Africa as a region continues to fall short of the 7–8 per cent necessary to achieve the MDGs target on halving poverty.

To raise the growth rate and sustain it at the level that will allow African countries to halve poverty by 2015 requires a significant increase in the volume of foreign and domestic resources devoted to promoting overall development in general, and poverty reduction programmes in particular. There have been numerous international initiatives aimed at increasing the volume of official development assistance (ODA) and its grant element to poor countries.[1] However, donors are not on course to meet these pledges (OXFAM, 2007; The Economist, 2007), and the overall effect of these resources on poverty reduction has remained marginal. The limited development effectiveness of ODA has been partly associated with the inefficiency in the use of aid, which has resulted in relatively small amounts effectively used for development purposes (UNCTAD, 2006a). Foreign direct investment (FDI) flows to Africa, though on the increase in recent years, are still too limited in geographical coverage and focused on extractive industries to have a significant effect on employment creation and poverty alleviation (UNCTAD, 2005). In this regard, harnessing domestic financial resources could help raise additional financing in order to narrow Africa’s resource gap and accelerate the process of economic development and poverty reduction. Moreover, reducing dependence on donor funds and associated conditionalities would increase “ownership” of the development process whereby these resources could be used to fund countries’ own priorities rather than those of the donors.

There are several potential sources of domestic finance that could provide important additional development resources if they were properly tapped. However, the policy actions taken so far to increase the total development resource envelope do not sufficiently recognize that African countries need to step up their efforts at enhancing domestic resource mobilization. Firstly, some public finance reforms have been implemented to increase government revenue, but they have been limited to basic issues such as the introduction of broad-based consumption taxes, mainly in the form of value added tax. The effect on government revenue has remained limited. Secondly, little effort has been made to mobilize workers' remittances, a major external resource for a number of African countries. Currently, the flows of remittances largely bypass the banking system. They are channeled into consumption and, to some extent, real estate development, with little positive impact on development. Thirdly, there have been no concerted efforts to tap investible resources from the large and vibrant informal sector in African countries. Fourthly, capital flight continues to deny African economies large amounts of the continent's own resources that could have funded domestic investments that create jobs and provide or boost incomes of the large segments of the population that are unemployed or underemployed. Fifthly, the reforms in the financial sector have focused on interest rate liberalization and the dismantling of entry barriers in the banking sector to increase competition in order to improve the quality of financial intermediation. So far, the results have been mixed.

Africa's financial resources needs

African economies have been enjoying a period of relatively strong economic performance over the past few years. This is an encouraging change from the previous decades, when economic performance was either negative or stagnating. The growth rate for the continent was 5.7 per cent in 2006, exceeding even the record rates of 5.3 per cent in 2005 and 5.2 per cent in 2004 (UNECA, 2007). The sub-Saharan African region, meanwhile, recorded a per capita gross domestic product (GDP) growth rate of 3.4 per cent in 2005, the highest since 1974 (World Bank, 2007a). This impressive performance is principally due to rising prices for primary commodities, benefits from macroeconomic stability and reform, substantial inflows of external financing and debt relief (UNECA, 2007).

Despite strong macroeconomic performance since the turn of the century, the growth rates achieved are still insufficient for the continent to achieve the objectives of the MDGs by the target date of 2015. From 1998 to 2006, only five countries in Africa (Angola, Chad, Equatorial Guinea, Mozambique and Sudan) grew at 7–8 per cent growth rates necessary for halving poverty (UNECA, 2007). Additionally, although the region as a whole has enjoyed good economic performance in recent years, growth rates remain dependent on a small number of primary commodities and high average growth rates mask large differences in performance across the region. Furthermore, recent economic growth has not translated into corresponding increases in employment, and the limited job creation that has taken place has mainly been in the informal sector, due to the capital-intensive and enclave nature of the extractive sectors that have been driving this growth (UNCTAD, 2005; ILO, 2007). This phenomenon of "jobless growth" is a major preoccupation of African Ministers of Finance, Planning and Economic Development, as expressed in Abuja in 2005 (UNECA, 2005b).

Policy choices, political stability and the external environment all play crucial roles in defining the economic performance of African countries. Regardless of the situation, however, the availability of resources for socially and economically productive investment will be a necessary condition for a more balanced growth trajectory based on economic diversification (UNCTAD, 2003) and employment creation. Current resources are neither sufficient nor stable enough to allow the region to fully attain the first Millennium Development Goal by 2015 (UNCTAD, 2000a; UNCTAD, 2005; UNCTAD, 2006a; UNECA, 2006).

Estimating the cost in resources of achieving the MDGs is necessarily a speculative exercise. These estimates do, however, point to the order of magnitude of the existing resource gap. It is believed that, across all developing countries, an additional $50 billion to $76 billion per year is needed to reach the MDGs. In Africa, the need for additional resources is generally believed to amount to between 10 and 20 per cent of GDP (UNECA, 2005a; UNECA, 2006; see UNCTAD, 2006a for more information on cost estimates).

UNCTAD estimated in 2000 that investment rates needed to reach 22–25 per cent in order to increase sustainable growth rates to 6 per cent (UNCTAD, 2000a). From 2000 to 2004, sub-Saharan Africa averaged investment rates of only 18.1 per cent of GDP, while the figure for all of Africa was 20.7 per cent. Explanations for these low rates tend to highlight the low savings rates as well

as the lack of profitable investment opportunities. Only seven countries in sub-Saharan Africa (Botswana, Chad, Eritrea, Gabon, Lesotho, Mozambique, and Sao Tome and Principe) achieved investment rates above 25 per cent of GDP. In North Africa, however, investment rates were notably higher, averaging 25.6 per cent (World Bank, 2006).

The resource gap in Africa must be bridged using both external and domestic resources. There are, however, a number of problems related to excessive dependence on foreign capital flows (see UNCTAD, 2005; UNCTAD, 2006a). Strengthening of domestic resource mobilization, combined with improvements in the efficiency and efficacy in the use of such resources, will not only reduce or eliminate the resource gap. It will also increase the "policy space" available to the State to enable it to define its development goals and the means to attain them.

The objective of this year's report is to examine the potential of African countries to increase their total domestic resource envelope in order to reduce dependence on external resources, namely ODA, and diversify their development resources. Channelling these resources to productive investments to increase their efficiency is a complementary objective. To achieve these aims, the State will have to assume its role as a "developmental State", a concept that this report intends to bring back to centre stage (see chapter 3 for a discussion of this concept). Indeed, the African State must reclaim its developmental role in order to give true meaning to the rhetoric of "ownership" in macroeconomic and resource management.

Of course, resource mobilization will not by itself solve all the problems faced by African countries, particularly considering that many of them lack the institutions and human resources necessary to make development work. However, in the medium to long term, the ability of African countries to finance an increasing share of their development needs from domestic sources would give them much-needed flexibility in the formulation and implementation of policies that address their economic, social and other developmental challenges. The multiplicity of the challenges facing Africa inevitably calls for an appropriate "policy mix" or "diversity of policies" tailored to the specific situation of each country, rather than a one-size-fits-all approach. In this context, the report highlights the need for more policy space for African countries to design and implement policies that make optimal use of available resources in a way that

leads to a virtuous circle of accumulation, investment, growth and poverty reduction drawing on the model of developmental States.

Chapter 1 is a brief exposé of the salient issues involved in domestic resource mobilization within the context of African countries. Chapter 2 examines the challenges involved in raising the level of savings in Africa and discusses how the savings raised could be used to finance productive investments as a basis for sustainable growth. Chapter 3 delineates the characteristics of "developmental States" while examining their applicability to Africa. It argues that the necessary conditions are currently in place for African countries to tackle their developmental challenges within the framework of a "developmental State". Chapter 4, the final chapter, distils some policy conclusions from the preceding discussions.