



# Investing in **Africa's** **Future**



The ADB in the  
21st century

Report of the High Level Panel

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21st century

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# Foreword

When Donald Kaberuka asked us to lead the High Level Panel considering the future of the African Development Bank (ADB) and its role in ensuring Africa's success, we were honored to accept, struck by the implications of the undertaking, and eager to make a significant contribution to an institution on whom so many rely.

We have been fortunate to count as colleagues on the panel an eminent group of leaders from around the world who possess a tremendous depth and breadth of expertise in such diverse realms as the private sector, public service, academia, and international development. All share a heartfelt passion for the future of Africa and a strong commitment to the well-being of its people.

With its young and growing population and vast natural resources wealth, Africa could become a global economic success and a land of great promise for millions. The continent has enormous potential to succeed, but this potential has existed for generations. We are all sadly familiar with the story that is Africa: persistent poverty, ongoing conflict, lack of economic

union, unacceptable corruption, and the scourge of AIDS have all conspired to rob its people of the future so many others in the rest of the world take for granted.

We believe the ADB can and must become the premier development institution in Africa, providing a strong voice for and within Africa so that Africans can take their rightful place at the forefront of continental economic stewardship. With an elected African president, strong balance sheet, and representation in all African countries, the ADB is well positioned to do this. There is a compelling case why the ADB must assume this role, and we present a realistic and credible plan to achieve it.

Realizing the promise contained in this report will require collaboration, increased commitment of resources, and determination to overcome the inevitable obstacles. The challenge today is for shareholders and regional member countries to decide whether they share our vision for the ADB and, if so, to fully engage in making it a reality.

Joachim Chissano  
Co-chair

Paul Martin  
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# Executive summary

**Africa is on the move. Policy changes and improved governance and management have led to the highest rates of sustained growth since the days of independence. The proportion of the population in extreme poverty is no longer increasing; democratic change is becoming the norm; African-led efforts have reduced conflict. The global context is also favorable, with the large emerging economies creating new opportunities for Africa. More African countries are credit-worthy, and investment has increased. All this gives cause for optimism. The High Level Panel believes that Africa has its best chance in a generation to make rapid progress—an opportunity that must be seized.**

By 2030 Africa will be as populous as China and India today. It should be a stable, integrated, and more prosperous continent taking its proper place in the global community. But this outcome is not inevitable. To succeed, Africa will have to overcome poverty, disease, climate change, failing and fragile states, corruption, poor governance, and small, unproductive, uncompetitive economies. If the continent fails, another generation of Africans will be trapped in poverty with few opportunities to escape.

The High Level Panel's position can be summarized as follows. To reduce poverty Africa needs sustained and shared growth, driven by the private sector, with a more equal distribution of opportunities. Operating as 53 fragmented economies, Africa will never be able to trade competitively—it needs to be more integrated, with larger economic spaces. Goods and services must move more easily; infrastructure must facilitate not frustrate trade; institutions must be supportive and effective. Without integration, the continent will remain disjointed, with many small, shallow markets that are uncompetitive on their own and unattractive to investors. Underpinning this integration are capable states, offering good and accountable governance. Progress, or the lack of it, will be closely related to success in rebuilding post-conflict states and managing fragile situations.

There is no single development model to apply. Uneven progress has made Africa more diverse, not less. There are more middle income countries (MICs) and more countries aspiring to MIC status. All, rightly, want to take responsibility for their destiny, to move away from dependence on aid. For this, Africa will need strong, committed leadership, unrelenting national and regional efforts, and sustained

**“ The ADB has a clear mission: poverty reduction and development through growth and economic integration ”**

support from the international community. Commitments by African countries and by donors need to be translated into action.

Africa will also need appropriate continental institutions. The African Union is providing a political lead, but the continent needs an economic motor to facilitate implementation on the ground, to drive economic integration. The African Development Bank (ADB) must become that motor, as the premier development institution in Africa. It must be a voice for development in Africa and for Africa internationally. This is a message we heard loud and clear in our discussions with African stakeholders—and it is the bedrock for the rest of our report.

The Bank has a clear mission: poverty reduction and development through growth and economic integration. It has the right credentials: an elected African president, universal African membership, an exclusive focus on African development, and a strong presence on the continent, including its headquarters and growing network of country offices. And it can address the full range of Africa’s challenges by supporting public and private initiatives across the continent.

But the ADB is not yet there. It has human and financial constraints. It has lacked focus in its wide-ranging agenda. It has not been as effective as it should be. Even so, we are impressed by recent progress and by the dedication of management to realize the Bank’s potential. We also recognize that the ADB cannot claim premier status as a right. It must earn its place by delivering results, by demonstrating excellence, by showing that it adds value, by becoming an efficient and dynamic organization. This will not happen overnight. It will require focus on carefully sequenced reforms and growth. And it will require concerted support from shareholders and management.

The Bank has to be relevant to all its regional member countries. It must be much more than a conduit for aid. It must have the right instruments. It must be an essential part of the African architecture, together with the African Union. It must support African-led strategies,

taking a longer term view of what works, providing knowledge and advisory services as well as finance for productive investments. And it must provide an African perspective, generating knowledge in Africa, for Africans, responding to African concerns.

The Bank cannot work just at the national level. It must ensure that cities and towns have access to finance. It must also lend to the private sector. With economic integration as a prime objective, financing regional projects should be a distinguishing feature of Bank operations. Neither the ADB nor any other institution can adequately cover all of Africa’s diverse needs. Choices have to be made, and priorities established and maintained.

Nor can the Bank work in isolation. It must leverage its knowledge and resources through partnerships with other institutions and other donors. Otherwise there will be duplicated efforts and weak coordination. Leveraging through partnerships is not easy—it will require self-discipline on the part of shareholders and management.

#### **Four interlocking flagship areas of focus**

We believe that the ADB should now concentrate its resources and efforts on four interlocking flagship areas of focus, all essential for growth and economic integration: investing in infrastructure, building capable states, promoting the private sector, and developing skills.

#### ***Investing in infrastructure***

Africa will never become competitive, or realize its productive potential, without massive improvements in infrastructure. The needs are huge, variously estimated at \$20–30 billion a year. The cost penalties borne now by the private sector, particularly for transport and energy, are daunting, more than wiping out any comparative advantages Africa might have in, say, lower labor costs. Infrastructure is a precondition for, and an enabler of, growth, for private sector development, and for trade. And support to infrastructure will contribute directly to other sectors such as health, water, education, and agriculture.

**“ The ADB should concentrate its resources and efforts on investing in infrastructure, building capable states, promoting the private sector, and developing skills**

The ADB already has solid experience in infrastructure, and it has generally performed well. It has a mandate from the African Union to implement the infrastructure component of the New Partnership for Africa's Development (NEPAD) and leads several multi-donor initiatives. It must be more proactive and take more leadership in defining needs and priorities, designing strategies and action plans, bringing stakeholders together, and coordinating and managing implementation. It should help Africa build infrastructure to effectively mitigate and adapt to climate change through clean energies (hydro and wind power), all-weather transport, and irrigation projects. More of the resources available for infrastructure should be channeled through the ADB.

We include “soft” infrastructure, the investments to promote trade and integration and to remove the impediments imposed at borders, by regulations, and by inefficient services. We believe that more resources must be devoted to regional cross-border infrastructure. The ADB should maximize its own contribution by mobilizing more resources for integration, including grants and loans through its African Development Fund (ADF) and through a new solidarity fund to which African countries themselves and other donors could contribute. There should also be positive incentives for integration, including concessional finance for projects that create positive regional returns.

***Building capable states***

With effective and accountable institutions essential for sustained economic growth and social progress, building capable states must be at the heart of the ADB's work. Engaging in fragile and post-conflict states is an imperative, not an option. The Bank should have a leading role but intervene selectively, consistent with its other areas of focus. Its assistance must be flexible, fast, and consistent, well coordinated with other players. And additional financial and human resources will have to be directed accordingly.

The Bank should strengthen institutions responsible for financial management and the use of public

resources—and the oversight bodies and systems that hold them to account. It should build on the engagement with the African Peer Review Mechanism and on implementing the recommendations. It must have a zero tolerance for corruption in its own operations and in the use of resources it provides, taking immediate and decisive action when required.

***Promoting the private sector***

The private sector will drive growth in Africa. The ADB can help it do so by promoting an enabling environment, by facilitating investment and entrepreneurship. That means listening to the private sector, lending directly to private interests, and helping governments reform their legal and regulatory frameworks to strengthen governance and accountability. The ADB must better exploit the advantages of its integrated structure, building up country and regional strategies that encompass both the private and public sectors and foster the synergies between them.

Direct private sector operations tripled in the last year and should grow further. The Bank must draw in other financiers and take on some risk where the development returns for Africa are high. Doing so will put a premium on having the right skills and capacity in-house. Again, the ADB must add value. We believe that direct lending should focus on infrastructure, on agriculture and agri-business, on the extractive industries to help Africa get more from its natural resources, and on financial services.

***Developing skills***

The ADB should help Africa build the skills it needs to be competitive. In 2030 half of Africans will be under 25. Africa will have transitioned to a primarily urban population. Only economic growth can provide Africans with opportunities—but if they are to grasp these opportunities, they will need the right skills.

Given the heavy involvement of other donors in primary and basic education, the ADB should concentrate on vocational training, higher education,

and science and technology. The priorities should be building centers of excellence, providing the necessary infrastructure for education, and developing mutually supportive links with the private sector to promote the use of local skills.

### **Moving forward**

It is not enough to define areas of focus. Of equal importance is building the Bank's capacity to deliver. The president has begun a program of reform. More is needed. The ADB must better integrate its operations and develop an appropriate array of instruments. And to be more responsive to the needs of its diverse clients, the ADB and ADF should be brought together to tailor lending accordingly, operating as a single bank with a single board.

There is scope for blending ADB and ADF resources, consistent with the sustainability of debt and taking into account the quality and productivity of investments. The Bank sits on considerable financial capacity. Its triple-A-rated balance sheet could be used more productively to support the continent's development objectives—for instance by making transfers from middle income to ADF-eligible countries, blending lending rates, and increasing subsovereign lending. The Bank should explore these options urgently, calling on external expertise as needed.

We believe that good country performance must be encouraged and rewarded but that the ADF's aid allocation system has weaknesses that must be corrected. The ADB should develop a rigorous and well evidenced African model of aid allocation.

The ADB must increasingly provide expertise, experience, and advice to its members. We believe in the competition of ideas. Too often, however, the African perspective is absent or neglected. The ADB should become the recognized authority on African

**“ The ADB should become the recognized authority on African development, a credible and respected voice for Africa and within Africa**

development, the hub of a network for African policy and research, building understanding of what works in Africa and why—of how policies and investments translate into outcomes. This becomes increasingly important as donors focus less on preconditions to giving aid and more on results on the ground. The ADB must become more self-confident, able to act as a credible and respected voice for Africa and within Africa.

The aid architecture is changing radically with more donors and new players, including well endowed single-purpose and philanthropic funds. These positive developments are creating new opportunities. But they also put immense pressure on many African countries that do not have institutional capability to manage donor relationships, putting the country-led model under threat. The ADB should position itself to support African countries in managing and coordinating assistance, in accordance with their own priorities.

If the Bank is to become Africa's premier development institution, it must grow. Compared with similar institutions and indeed some bilateral donors, it is significantly understaffed and stretched too thin. Shareholder commitment to a cogent longer term vision for the Bank will be critical. Management and shareholders should develop a medium-term strategic accord that provides additional resources linked to specific deliverables and to performance. Without that accord, the Bank will be caught in the trap of not having enough resources to deliver what its shareholders want and of being denied additional resources on the grounds that it is not delivering.

The opportunity is waiting. Africa needs to have a strong African Development Bank as a recognized leader on the continent, driving economic integration and growth, building African expertise and knowledge. We believe that this opportunity can be—indeed, must be—seized.

# Toward a stable, integrated, and prospering Africa

**Africa can make faster progress and take its rightful place in a globalized world. The fundamentals are in place in many countries. Performance is better now than over the last three decades. Commitments of support are substantial. It is up to Africa and its leaders to seize and benefit from this window of opportunity.**

## **A vision for Africa in 2030**

The High Level Panel is motivated by an optimistic vision of what Africa can be in 2030. This is inspired by Africa's recent progress and by Asia's considerable achievements over the past several decades. We believe that Africa can transform itself into a stable, integrated, and prospering continent of competitive, diversified, and growing economies. Taking its rightful place in the world, it will be a continent with strong, integrated domestic markets, participating fully in global trade and investment. Peace and democracy will have taken hold in many more countries, underpinned by transparent and accountable governance. Borders will not be a barrier to trade, and subregions will be more integrated politically and economically. Driving this transformation will be skills, institutions, entrepreneurship, and community and individual empowerment.

Like Asia before, Africa will have reduced mass poverty substantially from the more than 40% today. More Africans will have access to clean water and sanitation, and they will enjoy better health, especially mothers and children. The major pandemics will be largely under control, thanks to stronger health systems and greater access to prevention and treatment. AIDS and tuberculosis will be in decline, and at least half the continent will be malaria-free.

With more than 1.5 billion people in 2030, Africa will be as populous as China or India. Africa's young people will be well schooled and well trained for good jobs. More than half will live in towns. Most will be employed, many in manufacturing and services, some in "South-South" ventures. African workers will be driving the continent's progression, with a vibrant private sector offering them good opportunities. Agricultural productivity will be much higher, increasing value addition, allowing greater crop diversification and exports, and bolstering food security. A slowdown in population growth will mean fewer dependents per worker and higher per capita incomes for viable futures. Men and women will have equal access to assets and opportunities.

Africa in 2030 will have overcome the economic barriers of long distances, low densities, and artificial divisions. With three times

China's land area, Africa will be one vast economic space, with highways connecting East and West, North and South, and with easy air travel to all the continent's capitals. Efficient transport networks and effective logistics systems will have slashed the cost of moving goods and workers, allowing the development of domestic markets, boosting trade within Africa, and enabling African firms to compete internationally. Reliable interconnected electricity grids will supply clean energy, powering human and business development.

Modern communications networks will reach towns everywhere, even many small villages, connecting Africans and plugging them into the world—giving them the information they need to work, to improve their lives, and to hold their governments to account. Economic integration at the continental level will be led by the African Union and at the regional level by regional economic communities (RECs) aligned with continental objectives.

With integrated markets, a well trained workforce, and indirect costs massively reduced by new infrastructure and the removal of bureaucratic constraints, Africa will have built its competitive advantage on lower-cost technically skilled labor. Good risk-adjusted rates of return and business opportunities will mobilize domestic resources and attract external investment. Africa's need for foreign development assistance will be greatly reduced. Access to finance on reasonable terms will be the norm not the exception, including that for small enterprises, women, rural populations, and micro entrepreneurs.

Supporting the continent's rapid and sustained economic transformation will be the adoption of new technologies: those that combat ill health, those that produce more crops per unit of land and water, and those that reduce, indeed reverse, environmental stress. Climate change adaptation and mitigation will be an integral part of continental development strategies.

Governments will have a long-term view of the sustainable exploitation of natural resources. They will have fully developed the capacity and skills to negotiate

**“ We are optimistic because conditions in Africa are more propitious today than in recent memory**

better deals with investors. Contracts will be open to scrutiny, and governments will make better use of the revenues received for the benefit of all citizens. Africans will demand transparency and hold their governments to account. Local communities will be consulted and involved as key stakeholders and beneficiaries of natural resource exploitation.

That is what Africa can and should be, but getting there is not automatic. Asia's experience shows that it is possible, but Africa in the last century shows that it is not inevitable.

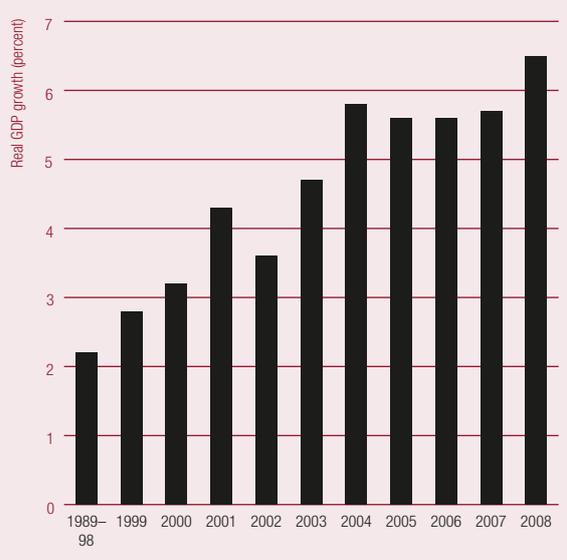
### **Why we are optimistic**

We are optimistic because conditions in Africa are more propitious today than in recent memory. For the first time in at least a quarter century, growth in the number of poor people has been arrested. Gross domestic product (GDP) growth, strong over the past several years, is forecast to remain so (figure 1). A favorable world economic context has helped, as has the emergence of new trading partners and South-South cooperation. Africa's macroeconomic reform and stabilization efforts have created a more favorable business climate. Indeed, nearly all of Africa's macroeconomic indicators are already positive: inflation, international currency reserves, fiscal management, and debt ratios all show encouraging trends (figures 2–5).

Clearly Africa's strong economic performance is driven in part by higher prices for many commodities, particularly oil. But this is only part of the story. Fifteen non-oil-producing countries, home to more than one third of Africa's people, have grown at an average of more than 4.5% over the past year<sup>1</sup> (further detail in annex 1).

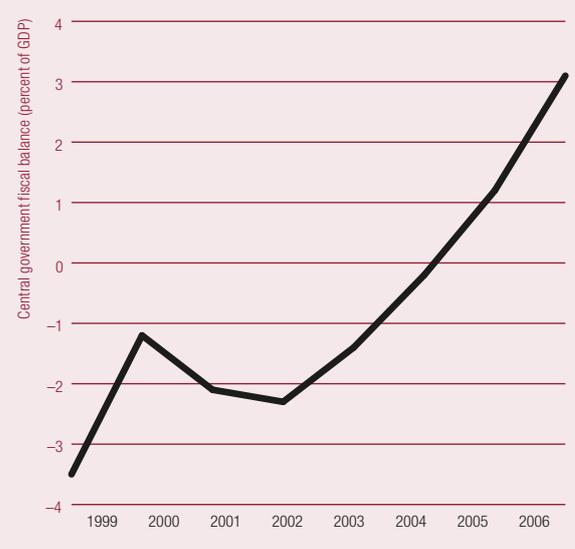
Africa is also moving toward greater stability and stronger governance. The African Union and the New Partnership for Africa's Development (NEPAD), a broadly accepted sustainable development initiative, are key elements of the emerging regional architecture. The NEPAD African Peer Review Mechanism (APRM) is an example of Africa's desire for better governance and its greater willingness to be held accountable.

Figure 1 | Real GDP growth is strong



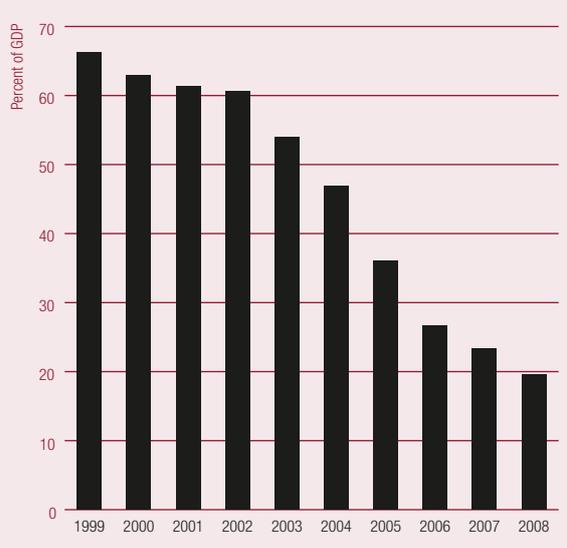
Source: International Monetary Fund, World Economic Outlook Database, October 2007.

Figure 2 | African budgets are better balanced



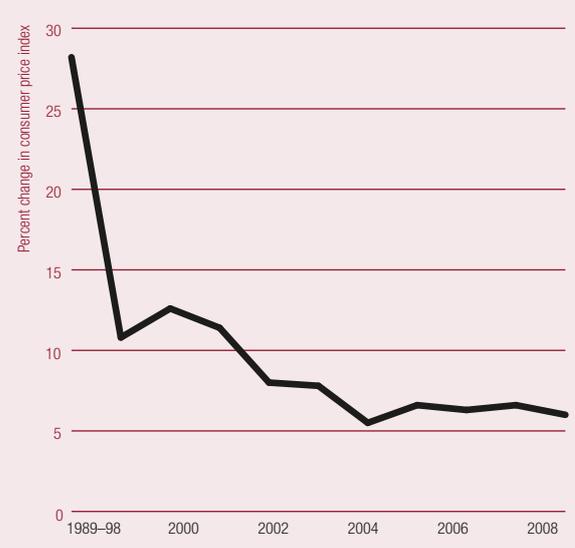
Source: International Monetary Fund, World Economic Outlook Database, April 2007.

Figure 3 | External debt is declining



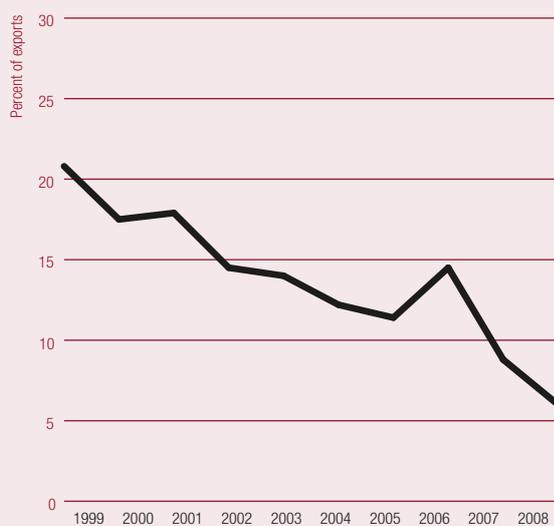
Source: International Monetary Fund, World Economic Outlook Database, October 2007.

Figure 4 | Inflation has been dropping steadily



Source: International Monetary Fund, World Economic Outlook Database, October 2007. Excludes Zimbabwe.

Figure 5 | The debt service ratio is improving



Source: International Monetary Fund, World Economic Outlook Database, October 2007.

The mechanism can be improved, but it is the only peer-driven initiative in the world today. Government transparency and accountability, particularly in the management of public expenditures, are increasing. Armed conflicts have declined. Democratic transitions are becoming the norm.

### The big challenges Africa must address

Of course, the picture is mixed, with the average disguising wide variations. Disparities in economic performance are increasing as individual countries respond differently to today's challenges and opportunities. Progress in many countries remains fragile, and the risk of policy reversal is real. In contrast to our vision of what Africa could be, the picture of an Africa in 2030 that has not addressed its challenges and seized its opportunities is desolate. Today's progress would be remembered as just the upswing of another boom-bust commodity cycle. The continent would be fragmented and uncompetitive, cut off from the global economy. Its mineral riches would be exploited, with the

“ But progress in many countries remains fragile, and the risk of policy reversal is real

profits going into the pockets of a few. Climate change would have increased competition for scarce land and water resources, increasing famine and fanning the flames of conflict. Population growth and urbanization would create vast slums, and poverty would become an increasingly urban phenomenon. With precious few opportunities, Africa's children would be condemned to an uncertain and limited future, their potential wasted.

We nevertheless believe that the continent can overcome its tremendous development challenges. But this will take time and concerted effort. If our vision of a successful Africa is to be realized, the following key challenges must be addressed urgently:

- *Overcome pervasive and persistent poverty.* Although poverty has leveled off, it remains unacceptably high across the continent. There are still some 300 million Africans living on less than \$1 a day.<sup>2</sup> No Sub-Saharan country is likely to meet the Millennium Development Goal of halving poverty by 2015. There is a real risk of a widening gap between Africa and the rest of the world.
- *Build stronger states.* Africa scores poorly in international governance comparisons. Many countries don't ensure political rights and civil liberties.<sup>3</sup> Although corruption is a global phenomenon, perceptions of corruption are particularly high across Africa and are correlated with poverty.<sup>4</sup> The prevalence of fragile states in Africa imposes significant costs not just on these states but on their neighbors. Civil war and regional conflicts have weakened many states, and ongoing conflicts continue to threaten regional peace and stability.
- *Increase productivity.* With abundant natural resources and burgeoning human capital, Africa should be a major beneficiary of globalization. But African productivity is much

**“ African leaders and the African people must seize the moment. Africans cannot be content with today’s progress**

lower than elsewhere. African economies are not competitive because they lack infrastructure, skills, institutions, and technology. Poor infrastructure leads to power outages, communication problems, and logistics delays that significantly increase the costs for African firms. Energy costs for firms in some African countries are 6% of total costs, six times those in such emerging countries as China.<sup>5</sup> Internal transport costs are at least twice those in Asia and Latin America. The result: smaller African firms, unable to compete internationally.

- *Overcome economic fragmentation.* Africa has more states than any other continent. Its small, fragmented, and shallow markets (the average national GDP is about \$4 billion) do not offer economies of scale. Many African countries must overcome geographic handicaps: 40% of Africans live in landlocked countries with no access to the sea. These countries are among the world’s poorest performing economies, with a significant and widening development gap with their coastal neighbors. Africa’s share of world trade has plummeted to a little more than 1%, and intra-African trade is low, only about 10% of total African trade. Foreign direct investment flows into Africa have declined to insignificant levels compared with other developing regions. If these trends continue unchecked, Africa will be cut off from the benefits of expanding world trade and investment, stuck on a low growth path.
- *Support growing populations.* According to the United Nations, Africa’s population will reach 1.5 billion by 2030, on par with both China and India, and 2 billion by 2050. By 2030 more than half its population will be under the age of 25 and the majority of people will live in urban areas, marking the transition from a primarily agrarian, rural continent. Only strong economic growth

can create jobs for the millions of new workers entering the labor force each year. And only good educational opportunities will produce a young workforce with relevant technical and managerial skills. Africa will need robust social systems and urban infrastructure to provide basic services and avoid the growth of urban slums.

- *Sustain natural resources.* Population growth and climate change will put pressure on Africa’s land and water resources. Although not of its own making, increased climate variability already adversely affects its water resources, land, forests, and biodiversity. Continuous climate changes will threaten food security and foster disease and migration. Africa must also manage its commodity resources for maximum economic impact and diversification. Africa is not getting the full value for its resources, and it is depleting the value for future generations. Striking examples include Sierra Leone and the Democratic Republic of Congo, where considerable commodity exports generate a pittance in royalties for the country.<sup>6</sup>
- *Deal with disease.* It is estimated that AIDS claimed 1.6 million lives in Sub-Saharan Africa in 2007. The epidemic, having already left more than 11 million orphans across the continent, is reversing decades of progress in lengthening the life expectancy of Africans.<sup>7</sup> Tuberculosis is second only to AIDS as a cause of illness and death for adults, with 2.4 million cases and 540,000 deaths each year.<sup>8</sup> Malaria continues to plague the continent, preying particularly on children and the poor.

**Africa must provide leadership, take ownership**

To realize the Panel’s vision, African leaders and the African people must seize the moment. Africans cannot be content with today’s progress, which must serve as a

stepping-stone to a higher level of success. Africa must take the lead in setting the development agenda and in designing the policies and programs to develop and transform Africa. African leaders must raise their sights—to pursue what will be in the continent’s best interests and their countries’—by accepting short-term tradeoffs for longer term benefits. They must give substance to African Union principles on economic integration.

African leaders have to position their countries to make the best use of resources. They must strengthen public finance management systems to get results. Their budgets should direct domestic resources and increased foreign aid and investment to growth-enhancing areas and opportunities. With the right policies, including public interventions to stimulate investment, it should also be possible to increase the share of private investment in GDP, critical to sustaining growth over the medium and long terms.

**“ A strong continental development bank should be the motor for development and integration in Africa, and the ADB must be that motor**

African leaders should also be more assertive in managing their international relationships—taking charge, not passively taking what is decided elsewhere. Africa will need foresight, longer term strategies, and better program delivery. The continental and regional institutions should work within a comprehensive, coordinated, and coherent program of action. Stepping up to the next level requires genuine and more equal partnerships between Africa and the international community, with more space for African leadership and ownership.

The strategic role of institutions serving Africa should be framed accordingly. The African Union and its NEPAD program provide the broad policy objectives, but these institutions are not implementing agents. A strong continental development bank should be the motor for development and integration in Africa, and the ADB must be that motor.

## The ADB in the 21st century

**Africa needs a strong development bank—the ADB should be that bank. Its mission should be poverty reduction and development by promoting growth and economic integration. The ADB itself can have only one driving goal: to be the premier development institution in Africa. But it is not that now, and it will not be immediately. It must first prove itself. It should grow over time according to a well sequenced plan, focusing its resources and energies on the areas that will contribute most to its mission.**

The role of multilateral development banks has been called into question recently, especially with the improved access to capital markets for many developing countries. However, the situation in Africa is different. Because of its huge development challenges, Africa more than any other region needs a premier continental development bank:

- To underpin economic integration and, particularly, to undertake multinational investments where the regional returns are greater than those for any individual country and which may otherwise not be financed.
- To provide a range of regional public goods, particularly knowledge and advisory services, to transfer experience and best practice, and to be an African voice on development internationally.
- To channel development capital efficiently to all African countries on reasonable and predictable terms to finance their investment needs.

These tasks are far from easy. A continental development bank must be efficient and effective; it must also demonstrate where and how it can add value. It must be agile and proactive, attracting and retaining the talent it needs to deliver high-quality results for its clients. It should have a convening role, assembling the key players, taking the lead when appropriate. It should also have legitimacy in Africa, being relevant to all its countries and answerable to Africa.

We feel strongly that the ADB should become that bank. It has the right credentials: it is wholly focused on the development of Africa—all of Africa. It is based in Africa, and it has an increasing country presence through a growing network of 23 field offices. It engages with the full range and complexity of development challenges in Africa. It has integrated operations, lending directly to the public and private sectors. The president is always an African, and the majority of its shareholders

and staff are African. It thus brings a uniquely African experience and perspective.

It also has legitimacy in Africa. Unlike some other international financial institutions, the president is democratically elected and has the confidence of, and ready access to, African heads of state and other high-level political leaders, engaging them on sensitive matters of policy and politics. The Bank can foster a unique African voice on development issues across the continent and internationally.

Therefore the Panel's unequivocal and unanimous view is that the ADB must become the premier development bank for Africa. It cannot assert this as a right; it will need to earn it by excellence in what it does and by delivering results, by helping to increase economic growth and to reduce poverty. It has to be, and remain, relevant to all of its regional member countries, from MICs to fragile and post-conflict states. It must maximize its impact by working in partnership, particularly with other African institutions. This means truly collaborating with national and regional development programs. In some cases the ADB should take the lead. In others it may be appropriate to be an equal partner or to cede lead responsibilities to other partners.

We know the ADB is not there today, nor will it be there tomorrow. The Bank operates in a complex and competitive international aid environment. It survived a fundamental crisis in the 1990s, which eroded its financial strength and shareholder confidence. As a result, the Bank's voice has been muted. It is comparatively small, with financial and human resource constraints. Its portfolio is disparate and the quality mixed. And procedure bound, it has been quite inflexible.

But the ADB is improving. It has instituted profound reforms over the past ten years that have strengthened internal controls, modernized risk management, and restored its financial health. The ADB now has one of the strongest balance sheets of any of the multilateral development banks. We are impressed by the Bank's

**“The ADB has to be, and remain, relevant to all of its regional member countries, from MICs to fragile and post-conflict states**

new management, by the leadership shown, and by the sense of strategic direction. It is putting in place policies and programs that respond to the remaining challenges.

Even so, the ADB has much to do to become the channel of choice for development finance in Africa. Enhancing the confidence of its shareholders and earning the space and resources it needs to be more effective will take time and tenacity. It must build the capabilities of its staff, deepening and broadening its knowledge base. It must review its instruments and be more flexible and responsive.

We believe that our view of building the ADB into Africa's premier development bank has broad support across the continent. The increasing fragmentation in the aid architecture makes the Bank more relevant, not less. Africans told us that they want to reduce the burden imposed by a large number of donors with separate systems and demands. They want predictable multi-year funding that respects national priorities. They also want a source of technical advice, of knowledge and experience that can bring partners together. All want more resources channeled through an organization that is part of Africa, that understands and lives in Africa, and that is accountable to its member states. In other words they want to channel more resources through a stronger, more effective ADB. Donors talk about African ownership; they should listen to Africa's views.

### **Its mission—poverty reduction and development through growth and economic integration**

The Bank's mission must be to promote economic development and poverty reduction. We believe this can best be accomplished by promoting broad-based growth and economic integration. The links among growth, inequality, and poverty reduction are well established: growth is a primary driver of poverty reduction. But there is considerable variation across countries: not all trade leads to increased growth, and not all growth reduces poverty.

**“ The multifaceted challenges in Africa defy a single prescription. What is needed is a nuanced approach, tailored to the particular needs of each country**

To have a positive impact on poverty, growth must be structured to be inclusive, creating income-earning opportunities for all groups in society, including women, youth, and the rural poor—largely bypassed to date. This means developing vibrant domestic markets that provide opportunities for local entrepreneurs in a variety of sectors to add value, to expand and create jobs. When growth is driven only by export-oriented operations with limited economic spillover (for job creation and knowledge transfer), there are results on paper, but precious little impact on the wider economy. The bulk of African countries are agriculture-based, and poverty in Africa is primarily rural. To have the greatest impact on poverty, growth strategies in Africa will have to promote higher agricultural productivity. They must also give more attention to empowering women as a way of promoting faster, more inclusive growth.

There is no universally applicable model of how to get countries onto the path of rapid sustained growth. Effective strategies to manage geographic and resource endowments are important, as are policy stability and the effective and accountable institutions of a capable state. One of the criticisms of the Washington Consensus is that it has been applied without enough appreciation of the different country circumstances and of the social, political, and institutional realities. It is clear that the multifaceted challenges in Africa defy a single prescription. What is needed is a nuanced approach, tailored to the particular needs of each country, sensitive to their economic, political, and social circumstances, proceeding through dialogue, supporting country ownership, and rewarding success. If the African Development Bank is not able to do that, who can?

Greater regional economic integration in Africa has a clear development rationale (see annex 2). It is the best way for Africa to overcome the challenges of economic fragmentation and low productivity—by building larger and more competitive economic spaces conducive to intra-African and global trade and attractive to domestic and foreign investors. Economic integration also has a positive effect on regional peace and stability by creating

structures of cooperation and interdependence that become strong disincentives to cross-border conflict. The Bank, as an African institution, is well positioned to lead and to accelerate economic integration. It has a responsibility to the African Union and NEPAD to help frame priorities and bring regional institutions together behind a common continental agenda.

Economic integration should be a prime policy objective for the Bank and a distinguishing feature of its programs. Financing regional projects that promote integration should be a major component of the Bank's operations. Designing and managing such projects is inherently complicated, requiring strong coordination across different political and institutional contexts. They often take ten years or more to implement and need secure funding over that period.

Financing regional investments is one way to promote integration. The Bank can add value by supporting regional projects in a variety of sectors that include infrastructure (especially roads, energy, and water) and regional public goods (health, knowledge, and environmental preservation). But it must also provide broader support to the integration agenda: improving governance, strengthening the RECs, nurturing regional capital markets, and promoting trade. Currently many of the RECs have limited capability and weak track records. There is overlap and duplication among the RECs and little effective coordination among them. African Union discussions on rationalizing their structure are making slow progress. Only the RECs that provide the most value to their members will flourish.

Consistent with the drive for economic integration and higher productivity, we recommend that the Bank provide more, but selective, financial and capacity-building support to the RECs. (We note that the recent G8 Summit in Germany reached the same conclusion.) We are already seeing faster progress in East and West Africa where countries perceive common interests. Progress toward customs unions and common external tariffs in some RECs, such as the Southern African Development Community and the Common Market

for Eastern and Southern Africa, will force countries to make choices. The Bank's job should be to promote and support RECs that are providing value to their members.

### **Making tough choices, selecting priorities**

The ADB cannot do everything, and tough choices will have to be made. In the past, stakeholders have tended to ask the ADB to work across the full spectrum of development challenges. This has strained the ADB's capacity and fragmented its operations, making them less effective.

We believe that in the near term the ADB must focus its limited resources on areas that contribute directly to its mission and on areas where it has competence and can complement the work of others. In each the Bank must demonstrate excellence and show it can deliver results. The Bank should scale down or play a supporting role in areas where bilaterals, multilaterals, and foundations are taking the lead. Because the Bank cannot do everything itself, it must work purposefully to develop strategic partnerships with others to

**“ The ADB cannot do everything, and tough choices will have to be made**

ensure that Africa's essential needs are addressed in a coordinated manner, making the best use of each partner's competencies. The selection of interventions in each country must be client-driven, responding to country needs. The Bank must also take into account each country's capacity to absorb and deploy aid effectively.

While a sharper focus will be important initially, and there will be things that the Bank will not do, talk of wholesale abandonment of sectors is misplaced. Selectivity is not neglect. The Bank may support education, for example, by focusing on vocational training, leaving primary education to bilaterals and foundations that are already active. It may contribute to health outcomes through providing water and sanitation. Nor does greater selectivity mean that the Bank will not engage with new and emerging issues. Indeed, the Bank has an important role in looking ahead, identifying new challenges and opportunities. When the Bank has a useful role in meeting new challenges, it must build the capacity to deliver.

## Increasing productive capacity and economic integration

**The Bank has to demonstrate excellence and deliver results in its areas of focus, above all in building productive capacity and fostering greater integration. At the heart of the Panel's recommendations is the need to focus on four key challenges. First, leading the effort to give Africa the infrastructure it needs to grow and integrate. Second, building the capable states that are essential for sustained growth and social progress, with additional attention to fragile and post-conflict countries. Third, promoting the private sector, which will drive economic growth and employment, including by lending to them directly. Fourth, developing the skills that are needed for a competitive economy. We make more specific recommendations for the Bank's role in each area.**

Consistent with the mission for the Bank, we recommend that it should focus on four interlocking flagship areas of focus that will increase Africa's productive capacity, drive integration, and promote economic growth. These areas respond to Africa's key development challenges and to the changing international aid architecture, where the Bank can excel and can build institutional synergies:

- Investing in infrastructure
- Building capable states
- Promoting the private sector
- Developing skills

These flagships are part of our ambitious longer term strategic vision of a focused but fuller service ADB. The key is sequencing. To get there, management and shareholders will need to develop successive medium-term plans, agreeing what will be achieved, when, and how, linking priorities with human and financial resources. Existing activities must be refocused and restructured. New activities must be carefully developed. Promoting greater equality so that women have access to opportunities and to resources and so that their voice is heard must be mainstreamed across all these areas. In doing this, the Bank must earn the space and resources to do more things and to do them well.

The flagships do not operate independently. They are interlinked and provide a platform that can support productive capacity in the key sectors essential for economic growth (see box 1).

### Box 1 | Improving agricultural productivity

Improving agricultural productivity requires infrastructure, skills, and a thriving private sector. Agriculture contributes about 30% of Africa's GDP (with a range of 15–70%) and generates some 70% of employment. Its importance as a driver of both economic growth and poverty reduction cannot be overstated. The majority of Africans live in rural areas today, including more than 50% of the poor.<sup>1</sup> Agriculture also has a strong impact on gender equity, given the key role of women.

Africa's agricultural productivity is low in part because of infrastructure. Inadequate irrigation—only 4% of agricultural land in Africa is irrigated, compared with 39% in South Asia—limits yields and increases vulnerability to drought and climate change. The lack of transport infrastructure linking farmers to markets depresses their returns.

Increasing agricultural productivity is complicated and challenging. It will require incorporating new skills and technologies, expanding access to credit, and finding new approaches to overcome the largely unsatisfactory agricultural development programs of the past several decades. The agriculture challenge is too important for the Bank to be absent. Today's agriculture is largely market-driven and therefore a private sector activity. The Bank should approach it accordingly. Capable states must promote the required operating conditions: investing in infrastructure, knowledge, research, and skills as well as ensuring legal and regulatory frameworks conducive to investment and growth. The Bank must connect producers to local, regional, and international markets, encouraging them to move up the value chain.

There is a need to balance enhancing economic growth by improving smallholder competitiveness in

**“ Investing in infrastructure is the best way for the ADB to increase African competitiveness and capacity across a range of productive sectors**

areas where potential returns on investment are highest with ensuring that farmers and the rural poor can earn a living and have enough food.<sup>2</sup> Long-term investments in soil and water management can enhance the resilience of farming systems, especially for people in remote areas and those most exposed to the risks of climate change.

Africa needs a smallholder-based revolution centered on food staples but also on traditional and nontraditional exports. Biofuels are linking agricultural and energy markets. And such emerging economies as China and India are boosting global demand, but also their production.

Already focused on agriculture are such specialized agencies as the Food and Agriculture Organization (FAO) and the International Fund for Agricultural Development (IFAD) and such major donors as the World Bank and United States. The Gates and Rockefeller foundations have formed the Alliance for a Green Revolution in Africa (AGRA) with a focus to date on inputs and education. So the Bank can best contribute to improving agricultural productivity by working in partnerships and contributing through infrastructure—markets, conservation, feeder roads, storage facilities, and irrigation and other rural water programs—and by promoting a better climate for private sector agricultural development, including efforts to strengthen governance and regulatory frameworks and to improve access to credit for small and medium-size enterprises through appropriate intermediaries. The Bank's private sector window should lend directly to larger agriculture ventures, including public-private partnerships, to support economies of scale, rural job creation, and diversification into higher value-added products. Examples include horticulture and downstream processing.

#### Notes

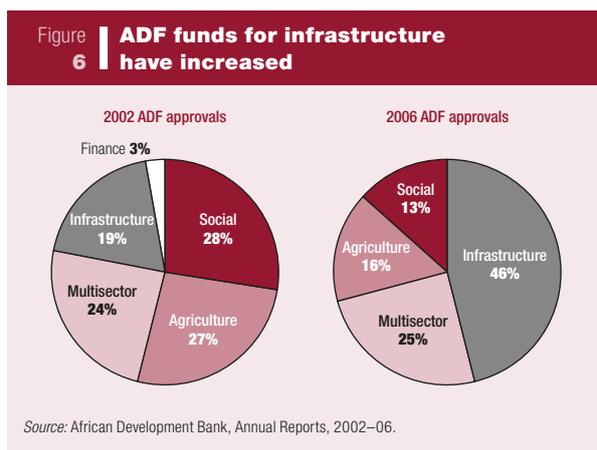
1. The 2008 *World Development Report* highlights evidence from China and India showing that growth originating in agriculture is three times more effective in reducing poverty than growth originating in other sectors.
2. World Bank (2007b).

### Investing in infrastructure

At the heart of our recommendations is that infrastructure is the best way for the ADB to increase African competitiveness and capacity across a range

of productive sectors: agriculture, manufacturing, and industry. The ADB already has a sharper focus on infrastructure operations (figure 6).<sup>9</sup> This can be the platform in the near term for demonstrating excellence,

**“ Africa’s needs for infrastructure are huge: the investments required to fill key infrastructure gaps are estimated at \$20–30 billion a year**



delivering results, and building a case for an expanded role.

We have outlined the challenge of poor infrastructure to African productivity, trade, growth, and ultimately poverty reduction. More resources need to be deployed to address the constraints to trade-led economic growth and regional economic integration. In many cases trade liberalization in Africa has not itself increased trade, largely because of internal barriers to trade and an inadequate productive capacity. Africa needs better transportation networks to move factors of production and products to markets. It also needs safe, reliable, and affordable energy and improved information and communications technology to enable a competitive private sector. Investments in infrastructure must support the development of strong domestic markets, the integration of regional and subregional markets for intra-African trade, and the positioning of a competitive Africa in global markets.

Africa’s needs for both national and regional infrastructure are huge: the investments required to fill Africa’s key continental infrastructure gaps are variously estimated at \$20–30 billion a year.<sup>10</sup> Africa needs these investments to grow fast enough to make a serious dent in poverty. But infrastructure has been relatively neglected recently by the aid community. Official development assistance (ODA) to Africa for infrastructure declined as a proportion of total commitments from near

40% in 1985 to 24% in 2005, as expenditures rose in the social sectors (figure 7). Most bilaterals followed suit. Now the trend may be reversing, with the multilateral donors giving more attention to infrastructure. The ADB has remained engaged in infrastructure, where it has strong experience and has produced good results, better than in other sectors and as good as other multilateral development banks.<sup>11</sup>

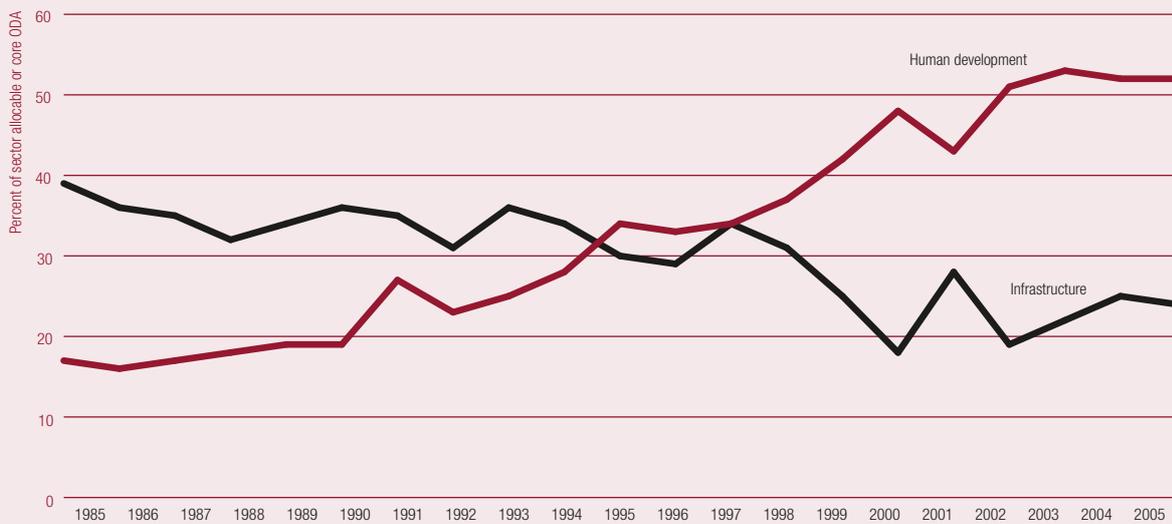
Recognizing the Bank’s good performance in infrastructure, Africa and the international community are looking to the Bank to do more. It has a mandate to lead on several key continental infrastructure initiatives: it leads the infrastructure component of NEPAD, it hosts the secretariats of the Infrastructure Consortium for Africa and of the African Water Facility, and it is financing the Rural Water and Sanitation Supply Initiative. The Bank must leverage its privileged role in these initiatives to be more proactive and drive delivery. Being a passive partner fielding requests for financing won’t suffice. The Bank must take a longer view, defining solutions, assessing country capabilities to absorb investment and expand capacity, and leading efforts to mobilize and structure financing, including that from the private sector. Consistent with this coordination and leadership role, a larger share of the resources available for infrastructure should be channeled through the ADB to avoid duplication or waste.

With support from the ADB, NEPAD has broadly defined Africa’s infrastructure needs. A first task for the Bank is to refine and sequence priorities. It must establish the physical gaps in infrastructure: in transport, in ports, in access to clean drinking water. It must provide advice on how to mobilize more financing for sanitation infrastructure, how to tackle energy and telecommunications, and how to best involve the private sector.

Africa, despite considerable energy production potential, consumes the least energy per capita in the world. This is both a cause and consequence of Africa’s poor productivity in the informal and formal sectors. Less than 10% of the rural population in Sub-Saharan Africa has access to modern energy. Increasing access

**“The Bank’s role in infrastructure must be seen in its broadest sense, as an enabler of productivity and growth, contributing directly to results in other sectors”**

**Figure 7 | Official development assistance to Africa: falling for infrastructure, rising for human development**



Source: OECD DAC database.

to safe, reliable, and affordable energy is therefore an imperative for the Bank’s work in infrastructure. This work should extend to the development of policy, to the institutional and regulatory framework that will encourage private sector participation, and to the capital investments in hard infrastructure.

A second task should be to identify the investments needed in soft infrastructure to promote trade and integration. One example: freight forwarders and express carriers, the movers of international trade, are a critical complement to trade-enabling infrastructure. In fact, transportation costs are more highly correlated with the number of competing freight transporters in a given market than with the distance to destination. But transport providers in Africa must cope with complex sequences of operations—from field or factory to warehouse, then to overland and sea transit often through several borders before reaching the final destination.<sup>12</sup> The speed and efficiency of the supply chains depend not just on hard infrastructure but on an array of public and private services: customs agents,

customs brokers, shipping agents, transport companies, and banks. Inefficiency and corruption at the border impose major costs on firms. According to one report, customs bottlenecks at southern African border posts cost the region \$48 billion a year.<sup>13</sup> It takes only one broken link to paralyze trade.

The Bank’s role in infrastructure must be seen in its broadest sense, as an enabler of productivity and growth, contributing directly to results in other sectors. Implementing rural water and sanitation programs can improve health dramatically by reducing waterborne disease, improve school attendance and performance, and support agricultural production.

Through the Bank’s work in infrastructure, it can also respond to climate change. Africa is responsible for only 3% of world greenhouse gas emissions, but the cost of adaptation to climate change could be 5–10% of continental GDP. African countries will have to formulate and put in place mitigation and adaptation strategies. The Bank must factor in the impacts of climate change by financing investments to produce clean energy,

**“ Building capable states must be at the heart of the ADB’s work**

build infrastructure that can withstand severe weather, and manage scarce water resources. (A more detailed account is given in annex 3).

Promoting integration will involve considerable investment in infrastructure that straddles country borders, that serves the interests of more than one country. Not easy, cross-border infrastructure requires intensive planning and implementation over a period of years. It also requires stability and certainty.

The Bank must have an array of instruments to meet the infrastructure needs of regional member countries. It must proactively and creatively develop solutions, introducing new instruments or products when necessary. In some cases it may lead with concessional resources. In others it may combine resources from both public and private windows. In still others it may provide technical assistance and capacity building in support of regional infrastructure or public-private partnerships, opening new opportunities for improving the supply and quality of a broad range of services.

Given the substantial unmet demand for infrastructure and other regional investments and the benefits that these investments will bring, more resources are needed. We recommend that the Bank increase the amounts set aside in the ADF for regional investments and provide incentives for countries to participate in these operations. It should also combine resources from the ADB and ADF windows.

The Bank should also create a solidarity fund wholly focused on promoting economic integration, especially through cross-border infrastructure, driven by continental and regional priorities. Africa collectively has more than \$300 billion in currency reserves. Some could be invested in projects that would produce a good rate of return. As a tangible demonstration of their support for Africa’s integration, regional member countries should take the lead in establishing the fund, but it could also be open to other donors. Experience elsewhere, as in the European Union, attests to the longer term benefits of such a fund.

**Building capable states**

A capable state is essential for sustained economic growth and social progress. Policy prescriptions and the promulgation of rules are of little use without the capacity to implement them. Aid is of equally little use if there is no project management and implementation capacity. Such capacity is particularly lacking in Africa. So building capable states must be at the heart of the ADB’s work. The recent debt relief gives breathing room to countries that previously were heavily indebted; they must now avoid inappropriate borrowing and show that the resources saved are producing solid development outcomes.

The Bank, currently involved in a disparate range of governance-related activities, needs more focus in its governance work. Its portfolio of governance operations is small and lacks clear direction. As an African institution and with an elected African president, the Bank should play a privileged and distinctive role. For that it needs a coherent, more focused strategy.

We recommend that the Bank’s priority should be strengthening country systems, particularly the institutions responsible for financial management and the use of public resources. This would include the management of natural resources and the institutions and the audit and accountability systems that hold governments to account. It would also include governance measures that support business and that provide a more attractive environment for investment. Institutional improvement is critical for sustained, pro-poor growth and for better delivery of basic services. The Bank’s work in governance will be cross cutting and will contribute to other sectors by strengthening the financial and procurement systems that underpin successful implementation of projects and programs. This will be a major contribution to expanding Africa’s capacity to manage and deploy scaled-up development resources.

The extractive industries in Africa have huge potential. But will they prove to be a “resource curse” in the 21st century or a development trampoline? The answer depends on how well Africa governs and manages these

resources. The Bank can and must make a difference. It should raise its profile in the Extractive Industries Transparency Initiative (EITI) to promote transparency, prudent use of revenues, and best practice standards for technology transfers and sustainability. The lack of a clear lead agency has hindered efficient coordination and more effective implementation of the EITI so far. Thirteen African countries have now endorsed the EITI principles, but many lack implementation capacity. The Bank should help them.

To do this, the Bank first needs to expand its expertise in the relevant disciplines of licensing, managing, and auditing concessions and to build up an international network of financial and legal experts. This would be a valuable continental public good. The Bank's longer term objective should be to support all regional member countries in proactively embracing the EITI for the strategic management of extractive resources for sustainable and equitable growth. Willingness to adhere to the EITI principles sends an important signal to investors, and it should be a prerequisite for any Bank private sector financing. But the Bank should invest directly in extractive industry projects selectively; if the projects are commercially viable, funding will generally come from other sources.

As in all its work, responsiveness to country circumstances and close coordination and complementarity with partners are critical. The Bank's capacity currently is limited, and it will have to make clear choices in the immediate future to define a limited range of governance interventions where it can add real value and demonstrate excellence.

Its approach must combine lending and non-lending activities, encouraging high level dialogue, providing policy advice, and identifying and promoting best practice. Anchoring this approach should be its participation in the APRM process, where it is already collaborating with the United Nations Economic Commission for Africa (UNECA) and where it has a standard-setting role in economic governance. The Bank should take the lead in financing the implementation of APRM recommendations relating to

**“The Bank will have to define a limited range of governance interventions where it can add real value and demonstrate excellence**

financial and resource management and to transparency and accountability.

Corruption is a symptom of broader failures of governance. Africa is not corrupt; there are in Africa, as elsewhere, corrupt people. Tackling corruption demands action not just on the continent but by countries and companies outside Africa. To be a credible voice on governance and corruption, the Bank must start with its own operations. It must have a policy of zero tolerance for corruption in its operations and should have independent monitoring mechanisms to back it up. It must sanction those who break the rules.

The Bank must contribute to efforts to restore stolen assets and to improve systems and controls that prevent leakage. We are concerned about the activities of “vulture funds,” which buy debt that has been written down under debt relief initiatives and then demand full value. The Bank should work with the other development banks and national authorities to prevent such predatory activities.

Fragile and post-conflict states represent a special state-building challenge in Africa. Here ADB engagement is imperative. Countries in conflict and other fragile states lose 2–3% of GDP a year. Neighboring states suffer too: sharing a border with a fragile state can reduce growth by 1.6% a year.<sup>14</sup> These negative spillovers can destabilize bordering countries and hamper regional integration. The costs to the international community of dealing with humanitarian crises, providing famine relief, and supporting peacekeeping operations are huge and increasing. In 2005 emergency aid in Africa surpassed \$5 billion, more than 12% of all aid, compared with an average of just 2% in the 1980s.<sup>15</sup> To the extent that these costs are met from aid budgets, there is a real opportunity cost to productive investment.

The domestic human and financial costs of conflict and fragility are clear: poverty rates in these states are extremely high, child mortality is almost 2.5 times higher, and death from malaria is more prevalent. Despite their needs, fragile and post-conflict states receive less aid per capita than others. Yet research indicates that

**“ The Bank should have significant dedicated funds for post-conflict countries, drawn essentially from the ADF but also from other donors**

there are higher average returns to aid in post-conflict countries. Swift and effective post-conflict transitions are also critical to regional security. Roughly 40% of post-conflict countries fall back into conflict within ten years.<sup>16</sup>

There is an emerging consensus on how to respond. The OECD/DAC Principles of Good International Engagement in Fragile States highlight that successful development depends, at least in part, on a coordinated, integrated, and well sequenced package of political, security, economic, and administrative interventions. The principles recognize that each case is different and provide a starting point for the Bank. The purely political remains the domain of the United Nations and African Union, but increasingly these entities look to regional organizations to take a lead in mobilizing support.

The Bank can also build on the success of its Post-Conflict Country Facility (PCCF), which allows the Bank to mobilize donor resources for use alongside its own to help post-conflict countries clear their arrears to the Bank. This experience underlines the importance of flexibility and partnership, but also the need for additional resources to allow the Bank to re-engage quickly. The Bank does not currently have funds available to provide enhanced support to post-conflict states. Its resources are drawn almost entirely from performance-driven ADF country allocations, limiting the amount that can be deployed. The Bank should have significant dedicated funds for post-conflict countries, drawn essentially from the ADF but also from other donors who wish to increase their contributions to these states.

Engagements should be flexible, both in size and in the type of intervention, tailored to country needs and circumstances. For example, it is important to demonstrate quickly the gains from peace: restoring some basic infrastructure, helping to ensure basic services are available, and providing income-earning opportunities for former combatants. Assistance should be significant, predictable, and sustained, anchored in a medium-term perspective with disbursement benchmarks. The aim is to help countries return to

normal status, a transition period that can last ten years or more.

The Bank should also remain engaged in fragile states that are deteriorating or in crisis. We do not believe that this will create incentives for these states to perform poorly. The Bank's support in these cases should be limited financially, but the cost of inaction, of not arresting decline, is far greater than the risk of moral hazard. The Bank should intervene only in a few select areas: building state capacity and systems to manage resources, improving transparency and accountability, and potentially helping nonstate actors, such as nongovernmental organizations, deliver critical basic services that the government is not delivering. These areas clearly build on and reinforce the priorities already laid out for building capable states.

In engaging with fragile and post-conflict states, the Bank should also mobilize and help coordinate international support, establishing divisions of labor and complementarity. The United Nations Development Program and the World Bank are now developing a joint work plan on state-building in fragile states, and the multilateral development banks are harmonizing their efforts. The Bank must play the leading role in Africa drawing on its partnerships with UNECA, the African Union, and the RECs.

### **Promoting the private sector**

We know that business will drive sustainable growth, employment, and poverty reduction in Africa. Removing the obstacles to private sector development and promoting a sound business climate must become core objectives in all country and regional strategies. Domestic savings and investment rates in Africa are low, and foreign direct investment flows have declined to insignificance compared with other developing regions. There is thus an urgent need to improve the investment climate for both domestic and foreign investors. The Bank must play a major role in promoting an enabling environment for investment and entrepreneurship. This means reforming legal and

regulatory frameworks and strengthening governance and accountability.

The Bank should develop a differentiated and ultimately more effective strategy by fully exploiting its integrated public and private structure and broad range of instruments. With a more integrated approach, the choice of a private or public window becomes essentially a technical question: Which financing instrument best addresses the particular need? Although recent reforms have established a solid base for stepping up the Bank's private sector operations, many institutional arrangements must be further refined. The need to improve coordination and planning and to learn lessons across the institution is evident. The Bank must have the right skills to increase its understanding of the African private sector's needs and risks, to be more responsive, and to develop greater coherence across departments. The Bank also needs a strong credit committee, with the requisite expertise in-house, to review what can be technically challenging proposals and provide good safeguards.

We considered the possibility of establishing an independent structure for direct lending to the private sector, such as the International Finance Corporation in the World Bank Group. An independent structure could enhance focus, professionalism, the recruitment and retention of specialists, and the development of a "private sector culture." However, we believe that these advantages are outweighed by those of maintaining an integrated structure and using all the Bank's assets to support the common objective of private sector development. The Bank should instead strengthen its private sector department by creating a single point of entry for private sector lending and a well-staffed, dedicated organizational unit providing leadership, visibility, and focus. The Bank now has a range of private sector instruments—loans, equity investments, guarantees, and syndications—that can be used alongside sovereign lending. Examples include public-private partnerships in infrastructure or pairing financing for extractive industries with governance programs to enhance transparency and revenue management.

**“The Bank should play a catalytic role by mobilizing finance for deserving private sector projects that build productive capacity and create economic growth**

The Bank should lend to the private sector only when it can clearly add value. As a development bank it can do so to remedy full or partial market failure, capture spill-over effects, or promote public goods. It must be willing to take on some risk in innovative or potentially high-yielding projects. Its financing operations must not crowd out or substitute for private financing, but should play a catalytic role by mobilizing finance for deserving private sector projects that build productive capacity and create economic growth. In many cases this should be done through financial intermediaries: commercial and subregional development banks, microfinance institutions, equity funds, or “venture philanthropists” that have a strong entrepreneurial drive and are willing to bear risk themselves.

The Bank can be an effective, honest broker in private sector transactions. It can maximize development impact for its regional member countries by ensuring that transactions are in line with country strategies, that environmental, economic, and social impacts are systematically addressed alongside the financial rate of return. And it can provide a degree of comfort for entrepreneurs, helping mitigate political risk through its privileged access to African governments and decisionmakers. Investors feel more comfortable with the ADB as a co-financier, knowing that the Bank will help defend common interests.

The Bank should also increase development impact by ensuring that local communities are consulted and that they benefit fully from, say, the extraction of raw materials. Active and inclusive project design and structuring can reduce conflict, ensure that projects are a locus for job creation, and provide social and economic infrastructure while preserving environmental sustainability. Helping firms move into processing natural resources will enhance these opportunities, much as Botswana has done with diamonds, cutting and polishing gems in-country rather than exporting raw stones.

Direct support from the Bank can add considerable value in several areas. Infrastructure and agriculture were mentioned earlier. The Bank should also directly support

## **“ African countries must become active in encouraging African innovation**

the development of more robust banking and financial services and foster innovation.

*Supporting banking and financial services.* To grow, the African private sector needs more robust financial and capital markets. Banking systems in Africa are small in absolute terms compared with the rest of the world, but also in relative terms, a sign of limited financial intermediation and access to credit on terms affordable to both households and private enterprises. Although African financial institutions have liquidity, they are not currently reinvesting funds locally for a host of reasons: lack of investment opportunities, unfavorable regulatory environments, insufficient internal capacity and expertise, and perceptions of high risk. African capital markets, where they exist, are inefficient, small, and shallow, with limited liquidity.

The Bank must help unlock that liquidity by scaling up its efforts. To have the greatest impact, it now needs to decide where it can contribute most effectively and to adapt its assistance to the local context. Small- and medium-sized enterprises (SMEs) represent an important vector for growth and job creation but are difficult for the Bank to serve directly for reasons of scale and capacity. There is a clear case for the Bank to use intermediaries closer to the ground—local banks, funds, rural credit cooperatives—to ensure that these enterprises have access to finance for growth. Where existing commercial and microfinance banks are effective, the Bank can support their development by providing longer term financing, equity, or technical assistance. Smaller entrepreneurs also need risk capital to go along with debt financing. The Bank should support the development of local equity funds that invest in SMEs. It should also assist African financial institutions to bring down the cost of transferring workers’ remittances to the continent and to harness these huge flows for development.

The Bank should continue to support subregional development finance institutions, which can efficiently reach a range of medium-size clients that the Bank

cannot. The Bank should take equity stakes in such institutions and offer more flexible instruments, such as revolving credit lines for proven subregional partners. The Bank can also promote other nonbank financial institutions, including leasing and insurance companies, and strengthen local capital market development through local currency financing.

*Fostering innovation.* African countries cannot just be takers; they must become active in encouraging African innovation, attracting and adapting the best international science and innovation to meet the continent’s unique challenges. Biotechnology and related life sciences can help address tough health and environmental challenges. Africa should channel growing scientific and entrepreneurial capacity toward life sciences product development and commercialization.<sup>17</sup> India, China, and Brazil have been successful in this. We believe that it holds significant promise in Africa too.

Africa has some scientific capacity, with more than 36,000 full-time researchers in scientific fields. Nigeria’s National Biotechnology Development Agency receives \$263 million a year, while South Africa’s Biotechnology Strategy commits more than \$300 million a year. But the lack of synergy and knowledge flow between companies and science and technology actors hinders the commercialization of new health technologies, such as traditional medicine and diagnostics. Africa must thus invest in the modern scientific infrastructure that will allow for greater economic competitiveness in the longer term.

One of the greatest market failures facing many African countries is the lack of risk capital to support the development of innovative companies that have new ideas and technologies but do not yet have revenue streams. In developed countries this gap is filled by venture capital and angel investors. The Bank should crowd in private investment to support the development of knowledge-based and innovating economies by helping to bridge the financing gap for innovating SMEs.

In particular the Bank should support the development of national and regional centers of

excellence in the health sciences and in energy and environmental technologies. There are significant potential benefits from strengthening the linkages between life sciences and the private sector. These centers would facilitate and incubate innovation, supporting entrepreneurship and developing technologies. But they must do more than develop skills. They must enable African countries to capture the economic value of their own research and development investments by developing the infrastructure to convert knowledge into commercial goods and services that can meet the needs of national, regional, and global markets.

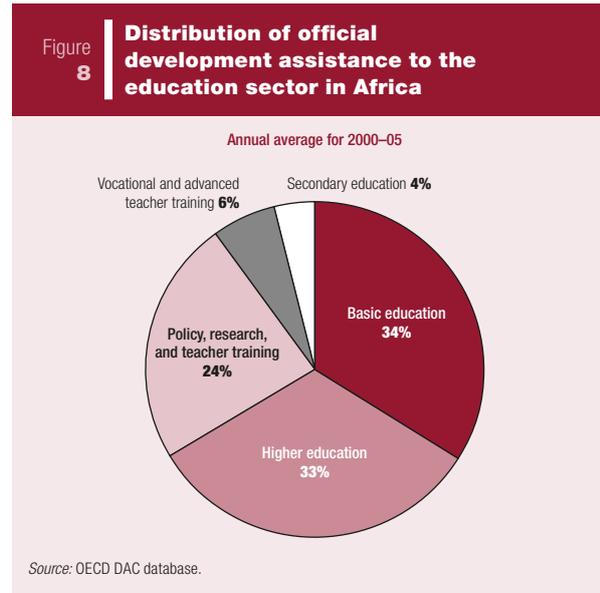
### Developing skills

Over the past decade, many African countries have improved primary school completion rates. The gross enrollment rate for primary education in Sub-Saharan Africa increased dramatically from 80% in 1999 to 97% in 2005.<sup>18</sup> They have received strong support from donors who have dedicated more than half of their education aid to primary schooling and general support (policy, research, and teacher training) (figure 8). Though much remains to be done, particularly to close gender gaps, the trend is positive.

But Africa is seriously lagging in higher education—with constraints on enrollment, mismatched worker skills and employer demands, a low retention rate for skilled workers, and limited ICT access and literacy. In Sub-Saharan Africa the gross enrollment rate for tertiary education is around 5%, compared with 23% in East Asia and 30% in Latin America.<sup>19</sup> In Korea 26% of those over 15 have tertiary education, in Ghana fewer than 2% do. There are some 228 million internet users in East Asia, but only 43 million in Sub-Saharan Africa.<sup>20</sup>

The demands of the education sector are so large that the Bank cannot address them all, nor does it have the human and financial resources to do so. The Bank should therefore support the sector in ways that complement the efforts of partners, many of which focus on primary education, general education support, and scholarships for higher education.

**“ We recommend that the Bank focus on vocational training, higher education, and science and technology**



We recommend that the Bank focus on vocational training, higher education, and science and technology. Well targeted vocational training will better align worker skills with the demands of the job market. A key goal would be to increase the percentage of secondary students receiving vocational and technical training in Africa, currently the lowest in the world. Higher education, particularly in science and technology, will help Africa close the knowledge and technology gap and adapt and use modern equipment and processes, allowing Africa to link into global supply chains. Studies suggest that increasing higher education completion rates can boost growth and productivity considerably through technology adaptation, entrepreneurship, and higher income and savings.<sup>21</sup>

The Bank has already developed some experience and capacity in these areas. A preliminary analysis of the Bank's education portfolio indicates that while lending has been fairly scattered, technical and vocational training and skills development have been the largest areas of concentration, accounting for roughly 37% of education lending, with an additional 10% going to higher education. It is clear, though, that the Bank will have to build internal capacity and expertise to play a

**“ The Bank should finance the building, upgrading, and rehabilitating of select higher education institutions**

meaningful role in these more specialized areas of the education sector.

To maximize synergies with the other areas of focus, we recommend that the Bank should give priority to:

- *National and regional centers of excellence.* The creation of centers of excellence should be supported to promote the harmonization of training programs, to provide platforms for scientific and technological research and exchanges with non-African institutions, and to establish networks to link students and researchers.
- *Infrastructure for education.* There is relatively little donor support for educational facilities. As part of its infrastructure effort, the Bank should

finance the building, upgrading, and rehabilitating of select higher education institutions, including research laboratories.

- *Links to the private sector.* Private investments in Africa are often constrained by the lack of local skilled and semiskilled labor. Foreign investors may resort to expatriate labor, increasing costs and limiting the potential development benefits from technology transfers and job generation. The Bank should link its work in the private sector with education and training programs that support the use of local labor and develop linkages that can add value in country—for example, in agriculture and agribusiness, in extractive industries, and in tourism.



## CHAPTER four

# Moving forward— How the Bank should work

**The Bank must be relevant to the needs of all its regional member countries. To do so and to promote growth and integration, it must operate as a single bank with a distinctive African perspective. It must have at its disposal an appropriate array of instruments and increased financial resources including an enlarged ADF, using net income and the untapped strength of its balance sheet. Regional members should also contribute, directly or through borrowings. The Bank's lending should reward performance and results. The Bank must become an authoritative voice on and for Africa. It should leverage its contributions by working strategically with Africa's key partners. It must be allowed to grow, building its capacity through a medium-term strategic accord with shareholders. Demonstrated increases in shareholder commitment will be critical, coming first and foremost from regional member countries.**

As we have made clear, the ADB in the near term must focus its limited resources on certain core areas, demonstrating excellence and delivering results to earn a bigger role in the future. Becoming a premier institution will require more resources, both human and financial, but the Bank can do more today by integrating its financing windows while increasing client differentiation, backed by a wider range of products. A solid knowledge platform and more effective partnerships will be indispensable.

### **Increase resources and integrate the African Development Bank and the African Development Fund**

The Bank faces a fundamental mismatch in its financing capacity and its clients' needs. It currently provides financing through two distinct facilities: the ADB and the ADF. The ADB has excess capacity, while the ADF has excess demand (see box 2).

To overcome this mismatch, the ADB should increasingly be managed as one bank, with one set of strategic objectives. It should bring together its concessional and nonconcessional windows, its sovereign and nonsovereign operations into a coherent whole. Resources must be deployed accordingly, and management and shareholders must work together to unlock the Bank's untapped financial capacity. There is more that it can and should do in Africa. Currently more than half of the Bank's risk-bearing capacity is

### Box 2 | A structural mismatch of supply and demand

The African Development Bank Group is structured as two distinct lending windows. The ADB window provides “nonconcessional” resources lent at market or near-market rates to middle income countries (MICs)<sup>1</sup> and nonsovereign entities. With a triple-A-rated balance sheet, it is strong financially. It has risk-bearing capacity to expand lending to MICs and nonsovereign entities and to take more managed development risk consistent with maintaining its financial strength. Because of the current eligibility requirements, however, only 15 of Africa’s 53 countries are eligible to borrow from the ADB window, limiting its playing field.<sup>2</sup>

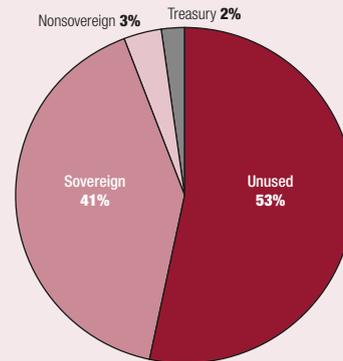
The ADF “concessional” window provides soft loans and grants to low income countries. Because its resources are highly concessional, the Fund must be replenished periodically with fresh donor contributions. However, the ADF is small and represents less than 5% of total ODA flows to Africa. Because the overwhelming majority of African countries, including the neediest countries, are not eligible to borrow from the ADB, they must share this limited pool of ADF concessional money. But its resources are insufficient to meet client demands.

#### Notes:

1. In reality there is some concessionality in ADB lending. Most MIC borrowers pay a higher country risk premium when borrowing directly in the capital markets.
2. Using the same eligibility framework as most other multilateral development banks, regional member countries are grouped in three eligibility categories according to per capita income: nonconcessional only (ADB), concessional only (ADF), or blend (access to both). In Africa, there are 13 nonconcessional countries, 38 concessional countries, and only two blend countries. The principle underlying this framework is the preservation of debt sustainability. Because nonconcessional resources have more onerous repayment terms, only the wealthier developing countries can tap them. Poorer countries are only provided “soft” loans and grants to ensure that debt burdens are not too heavy.

“The stark division between the Bank’s two lending windows should be revisited to give the Bank greater flexibility

Figure 9 | The Bank’s unused risk-bearing capacity



Source: African Development Bank, Financial Presentation, 2007.

unused (figure 9). It should not be content to invest more in the financial markets than in its lending operations.

The stark division between the Bank’s two lending windows should be revisited to give the Bank greater flexibility to blend concessional and market-rate resources. It must become more responsive to client needs and develop the range of instruments required. We note that bilateral donors, and some international organizations, already provide substantial resources on grant or concessional terms to ADB countries. At the same time, a growing number of lower income countries have received better credit ratings from the major rating agencies, opening for them the possibility of tapping international capital markets directly. Ghana is a recent successful example.

There is a huge difference between ADF resources (grants or highly concessional loans) and ADB resources (market or near-market loans). This implies a wide range in the middle where a single Bank could leverage its capacity by blending resources to meet client needs more effectively while respecting debt sustainability.<sup>22</sup> Appropriate criteria on ADB lending to these low income countries can be designed to safeguard debt sustainability, for example, by ensuring that projects generate revenues to provide for future debt servicing.

**“ There are a number of options for linking the Bank’s two lending windows, and management should explore them**

Greater flexibility is justified where countries can productively absorb more resources.

More lending should be directed to subsovereign entities, such as municipalities, especially those that generate revenue, and to the private sector. As discussed earlier, to be effective in its direct private sector and nonsovereign interventions, the Bank will need a variety of instruments that include loans, guarantees, and equity. These instruments should be adapted to the needs of private and other nonsovereign borrowers. State-owned enterprises and municipalities will have huge financing needs to keep up with growing demands for quality basic services at affordable prices (electricity, water, sanitation, transport). The Bank can use nonsovereign instruments to help fill these financing gaps. This effort should be tied to strengthening the Bank’s capacity to assess and manage nonsovereign risk.

There are a number of options for linking the Bank’s two lending windows, and management should explore them. Some of the most promising options include:

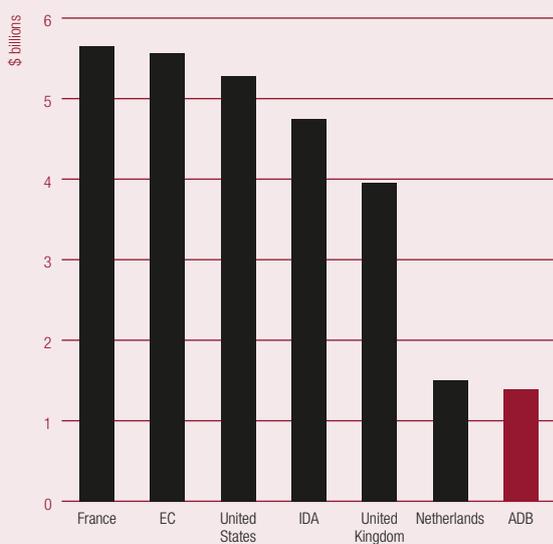
- *Eligibility criteria.* The ADB determines eligibility for concessional or nonconcessional loans based on per capita income, a narrow measure of needs. Human development indicators, for example, are a more comprehensive measure. Measures other than income could be considered in setting eligibility for the Bank’s two windows and could increase the number of countries with access to both.
- *Lending terms by project type.* Currently sovereign lending terms are based on the borrower country, regardless of the project. Defining lending terms based on the project type could add flexibility. For example, projects that do not generate revenues directly (poverty reduction programs, social sectors) could be financed on concessional terms regardless of the borrower country. Likewise, projects that generate revenues and thus have debt-servicing

capacity (electricity, water) could be priced on market terms.

- *ADB net income.* Over the past two years the ADB window has generated average annual net income in excess of \$300 million. Given the Bank’s current financial strength, we recommend that this income be deployed more aggressively to support the Bank’s development objectives. At the moment there is no compelling case to add more to reserves because the Bank’s risk exposure is already very conservative.<sup>23</sup> There are three main options for deploying income: increasing allocations to the Bank’s MIC trust fund, which provides some concessional resources to MICs, increasing ADB contributions to ADF, or contributing to a solidarity fund for regional integration. More radically, the Bank could go even further and carve out a portion of the ADB’s unused risk capital to support the solidarity fund; these are, after all, resources provided for the development of Africa.

At the same time many poorer African countries will continue to require significant development assistance, and the Bank should be enabled to play a greater role through a substantially expanded ADF. This would be consistent with the commitments donors have already made to double aid to Africa and, with the intent at the heart of the Paris Declaration, to provide more harmonized development assistance on a more predictable, longer term basis in support of country priorities. We conclude first that more aid to Africa should be provided through multilateral channels and second that the ADB should increasingly be the channel of choice. Currently the Bank is only the seventh largest source of aid for Africa (figure 10). While financial resources are not the only measure of the importance of an institution, we believe that more aid to Africa should be channeled through an African institution. This is also what we were told by Africans in our consultations.

Figure 10 | Sources of aid for Africa



Source: OECD/DAC database, 2005.

The Bank is a credible conduit and can do more now. It has a solid foundation, its capacity and effectiveness are improving, and it is more client driven. The ADF-10 replenishment is fully committed, leaving huge unmet demand from countries. Of course, the case for more resources must be built on the Bank's ability to generate results on the ground. Delivery on the ongoing institutional reform program is therefore imperative: greater selectivity, greater flexibility, more capacity for country dialogue, and more focus on portfolio quality and project implementation to lower transaction costs.<sup>24</sup> If the Bank is to position itself as a leader in budget support, large infrastructure transactions, or consortia supporting fragile states, it will have to be more responsive, with faster decisionmaking.

#### **Reward performance and results— with an African perspective**

As the ADF grows, a strong link between the allocation of scarce resources and country performance must be maintained, but the way this is done must be

**“ We believe that the performance-based allocation system is inadequate and should be reviewed**

improved. We have concerns about the current performance-based allocation (PBA) system. To provide incentives for good macroeconomic management, the ADF's concessional resources are allocated annually to eligible countries according to a formula that attempts to measure needs and performance. Needs are measured by population and per capita income (all else equal, more populous countries receive more resources and richer countries receive less). Performance is measured by a series of standardized historical indicators for governance, macroeconomic policy, and project portfolio execution, among others.

We believe that the PBA is inadequate and should be reviewed. First, by adopting performance indicators designed to be universally applicable, the PBA assumes a common development model that leaves little room for country-owned development strategies or continental diversity. Second, the assessment of need is too narrow. Third, much of the assessment is essentially subjective and backward-looking. It measures intermediate policy choices rather than results actually achieved and relies on data of often poor quality. Fourth, the annual allocation cycle introduces an unhealthy and unnecessary degree of uncertainty in planning and management both for the Bank and for borrowers.

There are two other problems with the PBA. One is that it does not deal adequately with the needs of fragile states and post-conflict countries. We have already argued in favor of more resources to meet the special needs of these countries. The PBA should be adjusted to allow for this. The other problem is that as an annual, country-based system, the PBA is poorly adapted to allocating resources to regional projects. A critical road or rail connection linking a good-performing landlocked country to a port in another good-performer may need to pass through a poorer performing country. Very big projects, such as the Grand Inga hydroelectricity project, can take at least 15 years to plan, design, and implement. Realistically,

**“ The Bank must have the ability to finance regional projects that cut across different client groups and to do more at the subsovereign level**

country-level performance will vary during that time. The potential benefits accruing from investments in regional integration should not be held hostage to the worst performer or to annual variations in performance by some participants. To lead on regional integration, the ADB needs a sufficiently flexible mechanism to fund regional projects.

We believe strongly that there should be positive incentives to promote economic integration, many of which can be regarded as akin to regional public goods, as stimuli to better economic trade and environmental performance, as essential preconditions for private sector-led growth, and as underpinnings of regional stability. Where there are good regional projects assigned a high priority by NEPAD or a REC and where the countries concerned are taking the necessary steps to make the investment productive, the Bank should drive implementation. We recommend, therefore, enlarging and “ring-fencing” the resources available for regional projects. We also recommend modifying the PBA system to reward countries that contribute to economic integration.

In short, a single standardized PBA system is ill suited to Africa's complexities. The PBA should be the basis for dialogue on what is to be achieved and how—a spur to improvement, not a straight jacket. It should reward countries for longer term development achievements by basing allocations on the country's track record of achievement and should be less prescriptive about the policies and strategies to get there. This would leave greater room for differentiated approaches that enhance country ownership. The resources provided by the Bank should be linked to sustainable medium-term economic frameworks based on commonly defined objectives and measures. They should be insulated from short-term fluctuations, particularly those from external shocks. The Bank should do the necessary analysis, and in the medium term it should develop a more African model, drawing on African experience and African analysis of what works best and when.

### **Increase client differentiation to remain relevant—with an appropriate array of instruments**

The Bank has a continental mandate and must remain engaged in all its regional member countries, responding to a diverse range of country needs. Its guiding principle must be to help countries move forward: from fragility and post-conflict transition to normative development, from low income to middle income status, from aid dependency to access to international capital markets and investment. It must be relevant to MICs as well as to fragile states.

Differences are likely to grow over time as countries with varying capacities deal in their own way with the pressures of demographic trends, climate change, globalization, and external shocks. This will require greater understanding of each market, greater analytical and policy dialogue capacity, more appropriate products and instruments, greater flexibility, and better management capacity. The Bank must also have the ability to finance regional projects that cut across different client groups and to do more at the subsovereign level. The Bank must have, accordingly, a broad array of instruments at its disposal and the flexibility to develop tailored solutions to concrete problems.

Project financing, particularly for large infrastructure investments, will continue to be a staple of its lending. But the Bank should be prepared increasingly to lend at the sector level or, where appropriate, to support the overall country budget. This is not an easy option. It requires agreement on a policy and performance framework and a dialogue on the allocation of resources. It also requires expenditure tracking and independent audit mechanisms. And it requires that borrowers have transparent and efficient budget control systems. But above all it makes government accountable to parliament and to its citizens.

Three criteria should guide the choice of instruments: country-owned strategy and the level of commitment, country and institutional capabilities to design and implement national programs, and

development performance. Different instruments will be appropriate in different country contexts, with a range of options for conditionality, policy engagement, tranching, and implementation and monitoring modalities. To be effective, all will require high caliber ADB in-country staff who are able to dialogue with ministers and heads of state.

At one end of the spectrum are countries that have demonstrated good performance and delivery. They have the institutional capacity, country systems, and planning mechanisms to take strong ownership and make the best use of resources. For them general budget support and sectorwide approaches set within a common policy framework and buttressed by policy dialogue in country may be most appropriate. At the other end of the spectrum are poorer performing low income countries and fragile states. They need long-term engagement, predictable aid with complementary technical assistance, and policy dialogue. For them a more structured project financing approach may be most appropriate.

The case of the MICs is instructive. During the Panel's consultations with stakeholders in the ADB, MICs made their specific needs very clear. They are looking for three things. First, they are looking for analysis and policy advice. They expect the Bank to be able to provide in-depth knowledge on key topics, drawing on best practices from across the continent. Second, they expect some degree of concessional lending, particularly to address poverty. Third, they want streamlined loan conditions and procedures to make their dealings with the Bank easier.

The European Investment Bank, for example, offers low rates with few conditions. It is not clear to the Panel why the same shareholders would endorse such conditions at one institution but not another. The Bank must react to these needs or lending activity will continue to fall, and the Bank will become increasingly irrelevant.<sup>25</sup> But the MICs must also realize that borrowing provides the income that allows the Bank to provide advisory and other technical services.

**“ MICs expect the Bank to provide in-depth knowledge on best practices, some degree of concessional lending, and streamlined loan conditions and procedures**

The favorable market conditions and low spreads that have given emerging markets unparalleled access to credit may not last. The Bank must be able to adjust to changing conditions. In addition, the Bank should exploit its financial expertise to develop new products and risk-transfer mechanisms that create greater stability for clients and reinforce development sustainability. An interesting option for the Bank to consider is “counter-cyclical” financing products. Taking various forms, they have in common the objective of reducing vulnerability to debt stress by insulating loan repayment from outside shocks. For a country whose economy is primarily based on cotton, for example, linking loan repayments to the evolution of world cotton prices (such as reducing loan servicing requirements when prices fall and vice-versa) would create a valuable hedge and be good for debt sustainability.

For all its clients the Bank needs to improve its delivery and speed up disbursement. It must streamline sometimes onerous procedures and conditionality and improve client service and responsiveness. The Bank has to demonstrate efficiency and effectiveness. We recommend management and the board agree on targets for improvement.

### **Build the Bank's knowledge platform**

The Bank must increasingly complement its financial services with knowledge services, including analytical and policy work. These provide the essential underpinnings for new policy initiatives and for the Bank's ability to respond to new challenges. We believe in competitive pluralism—in the competition of ideas in development. Knowledge is an essential tool for effective self-governance. In our discussions with African stakeholders, a recurring theme was the need for an authoritative knowledge platform to add a distinctly African viewpoint to international debates.

The Bank has already set itself a goal in the medium term to enhance its knowledge, research, and dissemination capacity and to provide intellectual leadership on development issues in Africa. This

**“ The Bank’s knowledge platform must bring to bear Africa’s existing intellectual capacity to generate research and knowledge in Africa**

includes country analysis, cross-country comparisons, and best practice identification and dissemination, including practices for development effectiveness. We strongly support this ambition. Achieving it will take time and resources. Shareholders must be prepared to make the necessary investment. But this does not mean that the Bank should do everything in-house. It can achieve more through partnership.

The Bank’s knowledge platform must bring to bear Africa’s existing intellectual capacity to generate research and knowledge in Africa, determined by an African agenda. The Bank should engage in issues of regional and continental interest and importance: trade, climate change, shared resources, and participation in the global system.

This is not a matter for one part of the Bank alone. Although orchestrated to a large extent by the ADB’s Chief Economist’s Office, building the knowledge platform is a matter for the Bank as a whole. It will require efforts on two fronts: leveraging external sources of knowledge and tapping internally generated knowledge. These efforts must be solidly focused on what is operationally relevant.

The Bank generates a wealth of knowledge every year through its operations across the continent. But this knowledge is not systematically captured, codified, or disseminated. Nor is it sufficiently valued by the institution, and this must change. Having country offices staffed with high-quality experts, close to clients, understanding the client perspective will help.

The Bank should be a repository of knowledge, able to draw on expertise and ideas from Africa and elsewhere, able to synthesize that thinking into policy and operationally relevant advice for its regional member countries. It should serve as an interface between knowledge and practical development application, enabling information and expertise to be widely and quickly shared. It should also be forward-looking, identifying and analyzing future development challenges, such as climate change.

The Bank’s knowledge platform should draw on the considerable knowledge and research already being

developed across the continent in existing knowledge institutions: universities, think tanks, and not-for-profit organizations. The Bank should build capacity, facilitate virtual networks, and empower existing institutions, providing resources for structured relationships to exchange staff and knowledge. The Bank should send staff to those institutions on short-term secondments and bring in researchers and experts on one-year fellowships to work on areas of particular operational interest. These experts would contribute research, mentor Bank staff, help develop policies, and raise the Bank’s profile.

**Become a voice for Africa**

Africa will continue to need support from the international community, but it needs to play a bigger part in the international discourse. Ongoing debates on aid and debt relief, trade, and development policy will affect Africa and its relationships with the rest of the world. Too often Africa’s voice is absent from these debates or is ineffective because it is dispersed among small countries with limited capacity to engage. One of the Bank’s core objectives must be to ensure that African views are taken into account. Its current areas of operational focus are a natural starting point for the Bank to begin to assert this voice: governance, infrastructure, fragile states, and regional integration and trade.

The African Union remains the political voice for Africa and heads of state. The Bank should play a supportive role, bringing a professional voice to development issues. It is well positioned to play this role. It can bring a uniquely African perspective, with the potential to generate, share, and leverage African experiences and viewpoints. It can speak authoritatively for the continent. And where appropriate it can participate itself, but it should also provide timely and relevant advice to delegates representing Africa in international fora. The Bank can bring together the larger donor community, which gives it an understanding of the broader development context. Fundamental to our report is a repositioning of the Bank and African

countries to have a stronger voice in improving the quality of aid and in determining how assistance is delivered.

The Bank should also be an authoritative voice in Africa. It should be the institution that African countries look to for guidance and information and to help set standards of best practice. It should also be proactive in advising them on wider international development issues and what those issues mean for Africa. The Bank must itself become a continental public good. The president should give a short account annually to African Union heads on the Bank's work.

### **Engage in strategic partnerships—to achieve more by working together**

The international aid architecture is changing rapidly, and the Bank must adapt with it. There are more donors than ever, a proliferation of multinational, national, nongovernmental, and not-for-profit organizations. There must be more harmonization and coordination and a greater focus on results, working together rather than competing. That means being open to new ideas, willing to share and cooperate with other players in the field of international aid.

There are two basic partnership dimensions for the Bank: its fundamental relationships with its borrowers and shareholders and its partnerships with others in the international community. The underlying principle for both is that, to be effective, development in Africa has to be led and shaped by African countries, and partnerships must be crafted accordingly. The principles, set out in the Paris Declaration, are too often paid lip service. They need to be implemented, and the Bank should take the lead in Africa.

As we have repeated, the Bank cannot do everything. Nor should it try. In some areas the Bank should play a leadership role. In others it should provide indirect support. In still others it can use its convening power to bring together support. These choices will determine its strategic partnerships with a variety of partners.

**“The ADB should be the institution that African countries look to for guidance and information and to help set standards of best practice**

- *Continental and regional partners.* At the continental level the Bank has a particular role in helping to deliver the priorities and programs agreed on by Africa's heads of state and in helping to provide the analysis for informed decisions. It must work in partnership with the AU Commission, the NEPAD Heads of State Implementation Committee, the APRM, RECs, and the UNECA. Partnerships with the RECs will be of particular importance in the selection, design, and implementation of regional projects. Enhanced partnerships with subregional development banks—for example, the Banque ouest africaine de développement, the East African Development Bank, and the Development Bank of Southern Africa—can deliver results. They are increasingly important regional actors, and the Bank should not be afraid to let them lead when appropriate.
- *Traditional partners.* Relations with traditional multilateral and bilateral partners must be maintained and strengthened. Strategic frameworks setting out areas of complementarity, sharing workloads and knowledge, should be agreed on by the key donors in Africa. Above all, the Bank needs a restructured partnership with the World Bank that provides a clearer division of labor. Relations with the European Commission covering trade, aid, and other policy questions should be strengthened. The Bank must be more assertive and earn the space to grow. Major bilateral donors will continue to be a primary source of aid for Africa. Solid partnerships with these countries can allow the Bank to be a channel for additional resources. The Bank's recent private sector development co-financing facility with Japan is a good example of what can be accomplished. These must be dynamic partnerships regularly refreshed, which they will be if both partners find them of value.

**“ To become Africa’s premier financial institution, the Bank must have greater human and financial capacity**

- *Emerging partners.* The Bank can play a role in structuring Africa’s partnerships with emerging donors to ensure that the continent’s needs and interests are respected and best practices observed. Specialized vertical funds, such as the Global Fund to Fight AIDS, Tuberculosis and Malaria, have a narrow focus on thematic issues across countries and regions. They have grown rapidly in recent years to some \$3 billion a year globally and account for some 19% of discretionary bilateral aid and 12% of multilateral aid. These funds should be seen not as a threat, but as welcome partners that will allow the Bank to sharpen its operational focus on areas where it can best contribute. Nontraditional donors have emerged, particularly China and India, creating new opportunities for South-South cooperation. China presents a huge opportunity but also a challenge. It is now Africa’s third-largest investor and trade partner. Traditional donors can learn much from China’s less paternalistic approach to cooperation. At the same time it will be important to promote transparency in the amounts and terms of aid provided and to encourage China to adhere to international agreements regarding debt sustainability, environmental protection, and untying bilateral aid. There has also been a rise in the number and importance of foundations and other not-for-profit organizations. The Gates Foundation is now as big as some of the smaller bilaterals, but with more clout in its target areas. We previously cited the Gates-Rockefeller AGRA as an example of how the Bank can partner with these foundations to achieve common objectives.
- *Knowledge partners.* As we already set out, enhancing the Bank’s research, analytical, and policy-dialogue capacity can be accomplished in large part through partnerships with strong

knowledge institutions in Africa and elsewhere. This will allow the Bank to scale up its knowledge activities faster and more effectively than building capacity exclusively in-house.

**Enhance the Bank’s capacity**

To become Africa’s premier financial institution, the Bank must grow. If it is to progress it must have greater human and financial capacity. This role will not be handed to the Bank. It must be earned by demonstrating greater efficiency and better results. The goal, however, must be shared by management and shareholders. The Bank’s progress toward the goal must be actively managed and monitored within a structured framework.

The Bank is making reasonable progress in changing the way it does business. Reinforced country and regional departments appear to be improving the operational focus and alignment with country-driven strategies. The Bank is decentralizing and now has country and regional offices to be closer to its clients, to improve service delivery, speed, and responsiveness, and to promote coordination with other donors and drive project implementation. We strongly support these efforts and believe that greater decentralization will be important for making the Bank a more relevant development partner. But the Bank should proceed with due care: to be most effective, decentralization must be accompanied by appropriate safeguards to prevent abuses.

We do not think that the ADB currently has the human resources to deliver as it should—a critical deficit. Management should prepare a detailed analysis of the alignment of human resources with strategic orientations while also considering the skill mix required, the Bank’s financial sustainability, and the need for high levels of efficiency. Africa does not need a bloated bureaucracy. It needs a highly effective and skilled development institution with appropriate capacity. Delivering on regional projects, assisting fragile states, and building up knowledge capacity will all require additional resources.

Our view that the Bank is understaffed is supported by comparison with other regional development banks. The ratio of staff to projects approved in 2005 was roughly 11 for the Bank compared with 20 for the Inter-American Development Bank and 27 for the Asian Development Bank. Comparing the ratio of staff with the number of country clients yields a similar result.

We strongly believe that management and shareholders should develop a medium-term strategic accord to build the Bank's capacity. This accord should establish sufficiently specific deliverables and indicators to allow performance to be tracked and monitored, but sufficiently flexible to allow for updating and adapting to changing realities. This framework should allow management and shareholders to grow the Bank quickly on the basis of a common understanding of objectives and deliverables on both sides.

In the near term the broad outline of this accord would be continued delivery by management on institutional reforms, including business processes, budgeting, and human resources. Shareholders must agree to higher administrative expenses to build capacity to deliver in the flagship areas and in knowledge. The Bank cannot be asked to take on new responsibilities and initiatives without the resources to deliver. If shareholders expect the ADB to play a meaningful role in emerging issues such as climate change, they must be prepared to fund it.

We note that the governors have said they will take a final decision by May 2008 relating to the Bank's return to its permanent headquarters. It is important that there is certainty for the medium term. Uncertainty hurts staff morale and recruitment, distracts management, precludes investment in adequate facilities, and undermines professionalism.

### **Increase shareholder commitment**

The Bank will never have the space and resources to become the premier development institution unless it has active support from all its shareholders. First and foremost are the regional member countries. If Africa wants the ADB to be the preferred channel for

## **“ Regional member countries can and should be prepared to augment the Bank's financial resources**

development assistance, countries must make their views heard more clearly. If Africa wants the ADB to be the motor for development and economic integration, eligible countries should borrow from the ADB window and demand that it provide the expertise and policy advice they want.

We believe that the regional member countries can and should be prepared to augment the Bank's financial resources. There are now MICs with good financial standing and considerable capital reserves. There is a compelling case for the regional member countries to put their resources to work for Africa's integration. As we have already argued, they could take the lead in establishing a solidarity fund, fully integrated within and managed by the ADB.

Governors have a special responsibility, not simply for the direction of the Bank, but to keep their respective ministers and heads of state informed. In turn, African leaders should reaffirm the importance they attach to AU-ADB cooperation. This would trigger a welcome shift in African countries' relations with the Bank—from one of simply clients to majority shareholders who see it as their Bank and who see the success of the Bank as linked to the achievement of Africa's own goals. The Bank's regional shareholders are its best advocates.

Nonregional shareholders are the primary source of capital for ADF, which itself is a very important source of finance for low income countries that cannot access nonconcessional resources. All have made commitments to increase aid to Africa. In keeping with declarations of support for African-led development, and for harmonization and more effective aid, a substantially enlarged ADF would signal their confidence at this pivotal time in the Bank's history. This should not be unconditional; they should expect results and hold the Bank accountable for achieving them. But they must provide the resources to allow the Bank to demonstrate that it can do so.

Shareholders acting through the Board of Executive Directors represent the highest policymaking body for the Bank, with management implementing these

**“ The Bank needs one board where all shareholders are represented and important decisions are made together**

policies. In line with best practice in both the public and private sectors, the board must focus on providing strategic direction, fiduciary oversight, and monitoring performance while giving management its proper space for day-to-day implementation. It should resist the urge to become involved in micromanaging the Bank, say, by allowing smaller projects to be approved by management. It should collaborate more with management with a sense of collective responsibility for achieving the Bank's goals.

In line with our belief that there should be a single bank, we also believe there should be a single board. Currently, the ADF is the point of reference for the majority of the continent, but its board is dominated by the non-African members that give most to the Fund. The Bank needs one board where all shareholders are represented and important decisions are made together. This would reinforce African representation and avoid marginalization of the African voice of the Bank.



## Africa's moment to develop and prosper

**The Panel's vision for Africa in 2030 is one of a continent that has overcome its major development challenges. To do so, Africa needs to build on the positive results it has achieved over the past several years. The most important challenge is tackling poverty. The percentage of Sub-Saharan Africans living on less than \$1 a day has fallen to an estimated 41% in 2005 from 47% in 1990. An increasing number of countries are making strides toward the MDGs, with some low income countries (for example, Ghana, Rwanda, and Uganda) aspiring to join the middle income group and pegging their ambitions beyond the MDGs. Yet the continent is still home to some 300 million Africans living on less than \$1 a day, and Sub-Saharan Africa is the only region not on track to meet the MDG target for income poverty. Much more must be done.**

Africa's macroeconomic indicators are positive. Real GDP growth is forecast to exceed 6% in 2008, up from 4–5% in 2005–06, and more than twice the 2–3% of the late 1990s. Underlying this growth are the broadening and deepening of markets. Following macroeconomic reforms, many African countries benefited from debt relief, evident in significantly lower external debt-to-GDP ratios. Inflation, nearly 30% in the later 1990s, is below 10% and stable. And while Africa had a fiscal deficit of 3.5% of GDP in 1999, it has produced fiscal surpluses since 2004.

The economic recovery has benefited from better policy frameworks and a broadly supportive international economic environment including higher oil and mineral prices. Fortuitously, the demand for raw materials has improved the prospects for African export commodities. On average, the price of oil has increased by nearly 30% a year since 2004. The prices of nonfuel commodities, led by metals, have increased by over 17% a year on average over the same period. Demand is projected to remain high for some time, driven by the needs of emerging economies. Many beneficiaries of this commodity boom now have significant liquidity and international currency reserves. Africa's reserves grew at a compound annual rate of more than 37% from 2004 to 2006—to reach 7.6 months of imports.

The economic recovery has also benefited from a decline in armed conflicts across the continent and from an overall improvement in governance. Central Africa, including Rwanda, Burundi, Congo, and the Democratic Republic of Congo, is making a successful transition

to greater peace and democracy. In West Africa, Sierra Leone is at peace and a reunification process is under way in Côte d'Ivoire. After nearly 20 years of civil conflict, Liberia elected Africa's first woman president in a transparent election in 2006. There have been more democratic transitions of government, improvements in the management of public expenditure, and increased demands for transparency from parliaments and civil society. A unique African program of peer review, the African Peer Review Mechanism, has been established, demonstrating self-confidence and a willingness to be held to account.

The importance of economic integration lies at the heart of the African Union and NEPAD agendas. Some regional economic communities, such as the East African Community and *Union économique et monétaire ouest africaine*, are forging ahead, driven by the common interests of their members. Others, such as the Economic Community of West African States, have played a vital role assisting the heads of state in tackling issues of conflict, peace, and security.

New opportunities are also opening for trade and South-South collaboration. China and India now account for 13% of Africa's total exports. The rapid rise in Africa's trading with China over the recent past has been particularly dramatic. During 1999–2004 the share of total African exports to China grew by 48% a year. This year alone China-Africa trade is expected to reach well over \$50 billion. At the recent China-Africa Summit, China announced its commitment to double aid and investment in Africa over the next three years. A \$1 billion fund to support Chinese industries investing in Africa has been announced and is expected to rise to \$5 billion.

These developments represent significant opportunities for Africa. Higher export revenues can, with appropriate investment policies, be plowed back into diversifying economies. To capture the benefits of these opportunities, Africa has to assert its own clear strategic interests in these new relationships.

While the quality of Africa's business climate still lags behind other regions, there are signs of progress and better prospects for investment. According to the *Doing Business 2007* report, Africa is the third fastest region in the pace of business environment reform, with two African countries (Ghana and Tanzania) among the top ten reformers worldwide. Similarly, the prospects for increased ODA are better today than they have been in years. If that aid is directed at growth-enhancing areas—such as infrastructure and productive capacities, especially in agriculture—it could further boost private investment from both domestic and foreign sources.

Remittances to the continent, more stable than ODA as a source of external flows, have also been growing rapidly—a boost for the continent, but also a sign that skilled workers are not finding good employment opportunities at home and are going abroad. Remittances rose from \$58 billion in 1995 to \$160 billion in 2004. ODA flows during the same period only increased from \$59 billion to \$79 billion.

In sum, Africa's prospects are positive. But it must not rest on its laurels. It must take advantage of these opportunities to redouble efforts. Increased resource flows today—from commodities, aid, and remittances—must be invested productively to increase economic diversification for more stable, vibrant economies tomorrow.

## The case for greater economic integration

**Africans have historically placed a high priority on unity through regional cooperation and integration. At independence the focus was on political unity and solidarity as an antidote to colonial marginalization. But this political goal has remained largely unrealized, and many now accept that political unity will take decades to achieve. This realization, together with the onset of economic decline in several African countries in the late 1970s, shifted attention toward the economics of cooperation and integration. The shift gathered momentum over the past decade and a half, and there is now growing recognition of Africa's particular economic challenges and the need for greater economic integration to overcome them.**

- *Geographic fragmentation.* Africa's countries are small relative to the rest of the world. Although Africa is the world's second-largest continent (30.4 million square kilometers) and the second most populous (more than 900 million people), its land and people are divided across 53 countries, creating the greatest number of states per square area of any continent. The average country population is less than 20 million, roughly half the world average.
- *Physical handicaps.* Africa has the highest concentration of landlocked countries of any continent. Fifteen African countries, home to 40% of Africa's people, live in countries with no access to the sea. These countries are cut off from international trade routes and must rely on neighboring countries to get their products to international markets or to obtain key imports. Another six island nations face challenges related to their geographic isolation. These physical handicaps impose tremendous costs that make imports expensive and exports uncompetitive. Transport costs for landlocked countries are 42% higher than those for their coastal neighbors, and there is a strong and negative correlation between transport costs and economic growth.<sup>26</sup> In short, physical handicaps are one of the key determinants, although certainly not the only one, of poor economic performance.
- *Policy incongruence.* As a result in part of Africa's large number of states and different colonial influences, the continent

presents a hodgepodge of policy environments covering a wide range of issues key to economic growth: trade and customs rules, technical standards (for rail transport, electricity, sanitation), financial regulations, currency and exchange rate regimes, legal frameworks, and investment and business processes. Differences across these policy frameworks cause “friction” for workers, businesses, and entrepreneurs that limit opportunities and slow growth.

- **Economic fragmentation.** Africa’s general economic underdevelopment combined with these physical challenges has led to economic fragmentation. Africa’s economies are small, with an average national GDP of about \$4 billion. Compare that with the world average of \$250 billion. African economies lack critical mass, diversification, and scale.
- **Economic marginalization.** Africa’s share of world trade has plummeted to a little over 1% and intra-African trade is minimal, only about 10% of total African trade. Africa has failed to diversify its exports beyond primary commodities, which in recent years have been dominated by oil. Foreign direct investment flows into Africa have declined to insignificance compared with other developing regions. Generally infrastructure is poor across the continent. If these trends continue unchecked, Africa will be cut off from the benefits of expanding world trade, stuck on a low growth path.
- **Unfavorable trade access.** Another important barrier to greater African participation in the global economy is unfavorable access to markets in developed countries. Developed-country subsidies on agricultural commodities such as cotton and escalating tariffs on processed goods put a drag on exports and discourage diversification.

### Taking advantage of globalization

Despite these considerable challenges, there are opportunities for Africa to develop faster and take advantage of globalization. Africa’s current growth momentum provides a platform and an opportunity to move forward. The global economy, thanks to the emergence of China, India, and other rising economies, has improved the prospects for African export commodities. The growth of these emerging economies is projected to remain high for some time to come. This should provide Africa with substantial export revenues that, with appropriate investment policies, can be plowed back into diversifying economies and developing appropriate specializations. Similarly, the prospects for increased ODA are better today than they have been in years. If directed at growth-enhancing areas such as infrastructure and productive capacities, ODA could lead to more private sector investment from both domestic and foreign sources.

However, because most African economies are small, a regional approach will be necessary in addition to strong policies and programs at the country level. This will facilitate the building of larger and competitive spaces, providing the scale to allow strong domestic firms to emerge and attract foreign investors. A key outcome will be a significant increase in intra-African trade, made possible by stronger regional infrastructure and harmonized trade policies. Economic integration can enable cheaper, faster transport of goods and services, particularly for landlocked countries, allowing the continent’s growth and development prospects to improve substantially. It would enable Africa to participate fully and capture a growing share of the benefits from global trade. With stronger regional cooperation and alignment of policy goals, Africa’s global voice and bargaining power will be enhanced. Over time this would transform the small country economies (through infrastructure, communication, and trade facilitation) and its largely poor 900 million people into an integrated and effective market.

### How the Bank can make a difference

The ADB's engagement in promoting economic integration will have to be selective, guided by a clear and explicit strategic and policy framework. The Bank's Economic Cooperation and Regional Integration Policy of February 2000 defined elements of such a framework, including a set of principles to guide the Bank. Some of these remain relevant and should be revamped using lessons from the implementation experience of the past few years.

On areas of strategic focus, the Bank has been given the leadership role in regional infrastructure under the NEPAD framework. Here the ADB must deliver if it is to remain credible in Africa. But to do so, it will need significantly increased financial resources and a central leadership and coordinating role in the proposed scaling up of infrastructure on the continent. According to recent estimates, Africa will need to invest 5–6% of GDP in infrastructure each year to achieve the rates of growth necessary to significantly reduce poverty.<sup>27</sup>

There is a risk that the funding of infrastructure has been spread across too wide a range of multilateral and bilateral agencies, which could lead to duplication and poor coordination. A well equipped and empowered ADB should lead and coordinate by convening and chairing a consultative group for regional African infrastructure.

In addition to infrastructure, there are other aspects of the economic integration agenda that the ADB should take on. These include governance, particularly the "soft" regional and continental infrastructure necessary to complement "hard" infrastructure investments. Trade facilitation measures, such as streamlining cumbersome customs procedures and harmonizing transport regulations, are an obvious example. Clearly, there are aspects of the agenda that can best be done by others. Effective partnership and coordination, especially with African institutions, will be crucial. To this end, the ADB should be active in building the capacity of RECs and NEPAD as motors of regional integration.



## Coping with climate change

**Africa has contributed the least to climate change but is likely to suffer the most. Greenhouse gas emissions from fossil fuel use in Africa are only around 3% of total global emissions. In fact, deforestation and other changes in land use, rather than energy use, are the main contributors to greenhouse gas emissions from Africa. Increased climate variability already affects its water resources, land, forests, and biodiversity, and these impacts are likely to worsen over time. According to the most recent report of the Intergovernmental Panel on Climate Change, the cost of adaptation in Africa could be as high as 5–10% of the continent's GDP. The challenges to Africa from climate change include:**

- *Reduced food security.* More than 95% of Africa's agriculture is rainfed, making it more vulnerable to climate variability than irrigated farming. In some countries the yields from rainfed agriculture could be cut in half by 2020. Two-thirds of Africa is already desert or dryland, with limited scope for agricultural production. Each 1° C rise in average temperature will reduce dryland farm profits in Africa by nearly 10%. The area suitable for agriculture, the length of growing seasons, and the yield potential, particularly along the margins of semi-arid and arid areas, are expected to decrease, reducing food security.
- *Increased water stress.* Three-quarters of African countries are in arid and semi-arid zones where small reductions in rainfall could cause large declines in river water. By 2020, between 75 and 250 million people could be exposed to higher water stress due to climate change. Water scarcity is even more acute in North Africa due to the very high population growth rates and already high rates of water use.
- *Growing competition for natural resources.* Climate change will make some currently populated areas less desirable or uninhabitable, spurring migration. Projections suggest that the number of people at risk of coastal flooding will increase from 1 million in 1990 to 70 million in 2080. Drought and other climate-related shocks will lead to greater water

interdependence and competition for farmland. If not managed, this could spark conflict and violence.

- *Higher risk of disease.* Africa is already vulnerable to climate-sensitive diseases, such as Rift Valley Fever and cholera. The Stern Review on the Economics of Climate Change estimates that with a 2° C rise in temperature, 40–60 million more people will be exposed to malaria in Africa, putting even more stress on already weak healthcare systems.

### From mitigation to adaptation

Much work on climate change, particularly in developed countries, has focused on mitigation (reducing emissions). But Africa is a minor contributor to global gas emissions and two-thirds of its greenhouse gases come from deforestation. Mitigation efforts in Africa should concentrate on avoiding land use changes. Central Africa has 20% of the world's remaining tropical moist forest, crucial for the global climate.

But even if global carbon emissions were reduced tomorrow, Africa would still be faced with adapting to climate change. African countries are the least prepared, in institutional resources and capacity, to address the consequences of climate change or to tap climate-friendly technologies. Africa needs a cross-cutting adaptation strategy covering energy, agriculture, forestry, and land and water management.

An adaptation strategy for Africa would allow the continent to minimize negative impacts and capitalize on opportunities for low-carbon growth and poverty alleviation, including multipurpose water storage infrastructure, rural biomass for land rehabilitation, bio-energy and carbon sequestration, irrigation, sustainable forest management, and carbon market development. The penetration of carbon finance mechanisms has so far been very weak in Africa. It is crucial to ensure that Africa can access and benefit from these markets.

### How the Bank can make a difference

The Bank should help articulate an Africa-based, Africa-specific vision for climate change issues and a strategy to address them. This would include analytical work to identify knowledge gaps, assess potential impacts, and develop climate change scenarios to aid the design and costing of adaptation strategies. The emphasis should be on helping African countries shift rapidly from managing climate risk as a purely environmental concern to addressing it as a growing threat to growth and development. The ultimate aim would be to mainstream adaptation into Africa's development plans. The Bank can start by explicitly addressing climate change in its projects.

The Bank should also help African countries build the capacity to analyze climate change and its development ramifications. It is crucial to support African countries in scaling up efforts to improve and increase access to climate and weather data, investing in and transferring adaptation technologies for adaptation in key sectors, developing and implementing best practice guidelines for screening and assessing climate change risk in development projects and strengthening cross-sectoral approaches.

The Bank should lead the charge in raising additional resources to cope with climate change. While adaptation will require investment across a range of sectors, energy will be particularly important. Universal access to safe, reliable, and affordable energy is an imperative for improving the quality of life, strengthening the capacity of African economies to compete in the global economy, and reducing poverty. Africa must continue to pursue this goal while limiting greenhouse gas emissions. The ADB should help Africa develop its largely unexploited hydropower and windpower potential. Less than 4% of Africa's hydropower potential is currently used. Unlocking this potential will require a variety of actions, including changes in regulatory frameworks to promote clean energies and investments in national and regional energy infrastructure.

## About the High Level Panel Process

**The ADB High Level Panel was established in 2006 by ADB President Donald Kaberuka as an independent advisory body to provide recommendations on the ADB's strategic vision and on the operational strategies needed in the medium to long term to achieve its vision. The Panel started its work in October 2006 under the co-chairmanship of former President of Mozambique Joachim Chissano and former Prime Minister of Canada Paul Martin.**

The Panel held its inaugural meeting at the ADB headquarters in Tunis in December 2006. This meeting included a discussion with the Executive Directors. The Panel held three additional meetings in 2007 in January (Paris), April (Tunis), and July (Paris). The technical team produced background papers for these meetings and circulated successive drafts of the report to the Panel members for comment.

In parallel, members of the Panel convened brainstorming workshops at the subregional level to seek the insight of African stakeholders with intimate knowledge of the Bank. A workshop for East Africa was hosted by the Central Bank of Uganda in Kampala in March 2007 and chaired by Central Bank Governor Emmanuel Tumusiime-Mutebile. A workshop for West Africa was held in Dakar in March and chaired by President Soumaila Cissé. President Chissano held a workshop for Southern Africa in Maputo in May, and Jean-Michel Severino chaired a workshop for North Africa in Rabat in July.

The co-chairs and members of the High Level Panel also interacted with governors, ministers, and other stakeholders at the ADB annual meetings in Shanghai in May 2007, the World Bank spring and annual meetings in 2007, and the third replenishment meeting of the African Development Fund in Bamako in September 2007.



# The High Level Panel

## The co-chairs

### *Joachim Chissano*

President Joaquim Chissano served as Head of State of Mozambique from November 1986 to February 2005. He was elected President in October 1994 and then again in December 1999, announcing that he would step down from office in 2004. Between 2003 and 2005, Mr. Chissano served as Chair of the African Union. In 2006 he was appointed the United Nations Special Envoy to Uganda. He recently received the inaugural Ibrahim Prize for African governance.

### *Paul Martin*

The Right Honorable Paul Martin was the 21st Prime Minister of Canada and is the Member of Parliament for LaSalle-Émard in Montreal, Quebec. He was first elected federally in 1988. Mr. Martin served as Minister of Finance from November 1993 to June 2002, during which time he was named inaugural Chair of the G-20, an international group of G-7 and emerging market nations. Mr. Martin currently co-chairs a \$100 million poverty alleviation fund for the Congo Rainforest Basin.

## The members

### *Soumaila Cissé*

Since 2004, Mr. Cissé has served as the President of the Commission of the West African Economic and Monetary Union (*Union économique et monétaire de l'Afrique de l'ouest, UEMOA*). In 2003 he served as the Commissioner for Mali to the UEMOA. From 1992 to 2002, Mr. Cissé served in several ministerial positions in Mali, including Secretary General to the President, Minister of Finance and Trade, and Minister of the Environment and Urbanization. Mr. Cissé has received a variety of distinctions, including Chevalier of the National Order of Mali.

### *François-Xavier de Donnea*

Mr. de Donnea is currently Minister of State and Member of the Belgian House of Representatives. He serves as chair or member of several intergovernmental delegations and institutes and is also Professor Emeritus at the University of Louvain. Throughout his career, Mr. de Donnea has served in a variety of roles in public service and academia—as Secretary of State for Development Cooperation, Minister of Defense, Member of the Belgian Parliament, Member of the

European Parliament, Mayor of Brussels, and Professor of economics and public management at the University of Louvain.

### ***Timothy Lankester***

Sir Tim Lankester is President of Corpus Christi College, Oxford University. Previously, he was Director of the School of Oriental and African Studies in the University of London. Prior to 1996 he worked at the World Bank and in the British Civil Service, serving as Executive Director on the boards of the World Bank and the International Monetary Fund and as Permanent Secretary of the former Overseas Development Administration. He was Private Secretary to Prime Ministers Callaghan and Thatcher. He has been a non-executive director of several major companies. He is currently Chairman of the London School of Hygiene and Tropical Medicine and is the UK Governor for the Asia-Europe Foundation.

### ***Emmanuel Tumusiime-Mutebile***

Professor Emmanuel Tumusiime-Mutebile has been Governor of the Central Bank of Uganda since 2001. He was previously Permanent Secretary in the Uganda Government for 25 years, where he was the chief architect of Uganda's homegrown macroeconomic stabilization and far-reaching structural adjustment program, which have led to high economic growth rates for two decades and reduced poverty substantially.

### ***Poul Nielson***

Mr. Poul Nielson has served in a variety of high level public service positions. From 1999 to 2004, he was in charge of development cooperation and humanitarian aid for the European Commission. Prior to that he was the Danish Minister of Development Cooperation, Minister of Energy, Head of Section in the Danish Ministry of Foreign Affairs, and a Member of the Danish Parliament. He has also served as Managing Director of LD Energy, an oil exploration company owned by the Danish Wage Earners Pension Fund, and on the

Board of Directors of Vestas, the leading wind turbine manufacturer. He was also a Member of the UN Secretary-General's Advisory Board on Water and Sanitation in 2004.

### ***Wiseman Nkuhlu***

Professor Wiseman Nkuhlu is the Chairman of Pan-African Capital Holdings (Pty) Ltd. He previously served as Economic Advisor to the President of South Africa and as Chief Executive of the Secretariat of NEPAD. Professor Nkuhlu has served as a director of a number of major companies. He also served as Chairman of the Development Bank of Southern Africa and as Principal and Vice Chancellor of the University of Transkei. Professor Nkuhlu has received a number of awards, including honorary doctorates from the Universities of the Free State, Stellenbosch, Cape Town, Pretoria, the Nelson Mandela Metropolitan University, and Witwatersrand and merit awards from the National African Federated Chamber of Commerce, the Association for the Advancement of Black Accountants, and the Black Management Forum.

### ***Ndi Okereke-Onyiuke***

Professor Ndi Okereke-Onyiuke has been the Director General and Chief Executive Officer of the Nigerian Stock Exchange since 2000. Before that she served at the New York Stock Exchange as Exchange Services Manager and Systems Consultant. Professor Okereke-Onyiuke has served on the boards of directors of several corporate firms, including Ivory Merchant Bank, Cooperative and Commerce Bank, and NAIRA Properties Limited. She has received many awards for exceptional leadership and academic excellence, including most recently the national award of Officer of the Order of Niger for distinguished service to the nation.

### ***Judith Rodin***

Judith Rodin has served as President of the Rockefeller Foundation since March 2005. Dr. Rodin was previously the President of the University of Pennsylvania and the

Provost of Yale University. She serves on a number of leading nonprofit boards, as well as on the boards of AMR Corporation, Citigroup, and Comcast Corporation. She is the author of more than 200 academic articles and chapters and has written or co-written 12 books, including *The University and Urban Revival*. She served on President Clinton's Committee of Advisors on Science and Technology. A member of a number of leading academic societies, including the Institute of Medicine of the National Academy of Sciences, she has received 14 honorary doctorate degrees.

#### **Jean-Michel Severino**

Jean-Michel Severino has been the CEO of the French Development Agency (*Agence française de développement, AFD*) since 2001. He began his career as Inspector of Finances at the French Ministry of Economy and Finances. In 1988 his interest in development led him to the Cabinet of the Minister of Cooperation and Development where he occupied successive posts as Technical Advisor, Chief of Geographic Coordination, and Director of Development. Mr. Severino also worked at the World Bank as Director for Central Europe and as Vice President for Asia in 1997, shortly before the beginning of the Asian financial crisis, which he managed at the Bank in accompaniment of the IMF programs. He contributed to the High-Level Expert Panel on the System-Wide Coherence of the United Nations and is part of the commission on the "White Book" on France's foreign and European policy.

#### **Joseph Stiglitz**

Joseph Stiglitz is Professor at Columbia University and Chair of Columbia's Committee on Global Thought. He is the co-founder and Executive Director of the Initiative for Policy Dialogue at Columbia. He has taught at Princeton, Stanford, and Massachusetts Institute of Technology and was the Drummond Professor and a fellow of All Souls College, Oxford. In 2001 Professor Stiglitz was awarded the Nobel Prize in economics and in 1979 was awarded the John Bates Clark Award. Stiglitz was a

member of the Council of Economic Advisers during the Clinton administration and served as Council chairman in 1995–97. He then became Chief Economist and Senior Vice-President of the World Bank in 1997–2000. He has written several textbooks, which have been translated into more than a dozen languages. He founded one of the leading economics journals, *The Journal of Economic Perspectives*. His book *Globalization and Its Discontents* has been translated into 35 languages and has sold more than 1 million copies.

#### **Paul Yuma Morisho**

Paul Yuma Morisho is currently Consultant and Director of Administration for Globacom Limited. He previously served as a Consultant for Group Challenge. Mr. Yuma has occupied a number of senior posts at the African Development Bank, including Secretary General, Director of Organization and Methods, and Advisor to the President. He also served on the board of directors of the Africa Reinsurance Corporation and as Executive Chairman and Managing Director of Air Zaire. His public service experience in the former Zaire includes positions as Public Inspector for the Treasury and Director General of the Road Network Office of the Ministry of Public Works and Territory Planning.

#### **The technical team**

Callisto Madavo  
Kwesi Botchwey  
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Elene Makonnen  
Geoffrey Manley

# Notes

1. Broadman (2006).
2. World Bank and IMF (2007).
3. According to Freedom House, only one in five African countries provide political freedom and adequate civil liberties.
4. Transparency International (2006).
5. Eifert, Gelb, and Ramachandran (2005).
6. For example, in Sierra Leone revenues from mining licenses and royalties were just 2% of production in 2005 according to IMF reports. In the Democratic Republic of Congo, accusations of overly favorable terms for investors have prompted the review of 60 mining contracts signed during the civil war and subsequent transition.
7. UNAIDS and WHO (2007).
8. Data for 2005 from WHO (2007).
9. For the ADF window, infrastructure, including transportation, energy, water and sanitation, accounted for about 46% of approvals in 2006, up from 19% in 2002.
10. Infrastructure Consortium for Africa (2007).
11. Based on project evaluations, the ADB's infrastructure operations achieve higher satisfaction ratings than other sectors and are implemented faster.
12. World Bank (2007a).
13. Chowdhury and Erdenebileg (2006).
14. Chauvet and Collier (2004).
15. OECD Development Assistance Committee database.
16. Collier (2007).
17. See, for example, the African Union and NEPAD (2007), United Nations (2007), and Commission for Africa (2006).
18. UNESCO (2007).
19. Ibid.
20. ITU (2006). Data for East Asia does not include Japan.
21. See, for example, Bloom, Canning, and Chan (2006).
22. The Bank's lending products can be placed on a continuum of concessionality as measured by their "grant component." The grant component or loan concessionality is calculated according to a common formula developed by the OECD Development Assistance Committee (DAC). At one end are pure market loans (0% grant component), and at the other are grants (100% grant component). The current financing terms of ADF loans provide a grant component of 85%. The OECD DAC has established 35% as the minimum grant component for official development assistance.
23. The ADB's ratio of broad risk-bearing capacity (reserves for losses, equity, and callable capital) was 186% of exposure (loans and equity investments) at year-end 2006, "the highest such ratio among rated Multilateral Development Finance Institutions." (Standard and Poor's 2007).
24. Faster, more efficient project implementation could lower project costs and increase benefits for countries. The Bank estimates that on average project costs increase by 5% a year due to inflation. Average economic returns on Bank projects are estimated at 15%, implying considerable opportunity costs to slow project implementation. The Bank's existing project implementation infrastructure can also be used more efficiently through greater delegation of authority and larger projects. Due to limited resources and competing demands, the Bank's projects are considerably smaller on average than those of its sister institutions.
25. Between 2000 and 2006, outstanding ADB loans fell by nearly 20% from UA 6.6 billion to UA 5.3 billion. The fall in demand for ADB sovereign loans is partly attributable to temporary factors, such as low global interest rates and increased liquidity for some MICs, providing opportunities to pursue more proactive debt management strategies.
26. Transport costs as measured as the CIF/FOB ratio. See Chowdhury and Erdenebileg (2006).
27. Ndulu (2007).

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**Africa needs a strong development bank; the ADB should be that bank. Its mission should be poverty reduction and development by promoting growth and economic integration. The ADB itself can have only one driving goal: to be the premier development institution in Africa. It is not that now and will not be immediately; it must first prove itself. It should grow over time according to a well sequenced plan but must now focus its resources and energies on those areas that will contribute most to its mission.**