

INTRODUCTION

THE 2007 AFRICAN DEVELOPMENT BANK GROUP ANNUAL MEETINGS

Thematic Seminars and Other Side Events



CONCEPT NOTES

By the Bank

1. The Role of Corporate Governance in Private Sector Development: Exploring Partnerships and Practices in Asia.
2. Fragile States and The Role of Extractive Industries in Africa.
3. Climate Change and The Challenge for Development.
4. The enhanced Performance Based Allocation (PBA) and The Debt Sustainability Framework/Debt Sustainability Analysis (DSF/DSA).

By Partners

1. Development Finance and China-African Economic Cooperation.
2. African/Chinese Enterprises Forum: African Investment, Financing and Risks.
3. Africa's Re-indebtedness Following the HIPC and MDRI Cancellations: Proposals for Better Debt Governance.
4. Environmental Considerations for Sustainable Development.
5. Growth and Responsibility in Africa: Presentation of the German G8/EU Program and Panel discussion on Sustainable Private Investment in Africa.

Shanghai, China – 14 and 15 May 2007

1. The Annual Meetings of the Bank Group Board of Governors represent a unique opportunity for knowledge sharing and knowledge dissemination among high level decision makers in Africa, key officials of the bi-lateral and multilateral development agencies, renown academicians, leading agents of non-governmental organizations, civil societies and the private sector.

2. Over the years, the Bank Group has capitalized on this unique gathering to organize a series of events prior to the formal opening of the Annual Meetings. These events have consisted of a Ministerial Round Table, High Level Seminars and other side-events seminars organized by various units of the Bank and development partners. In the past, other side events seminars were implemented by various units of the Bank, each unit taking responsibility for the planning and organization of its seminar. This year, the African Development Institute in the Chief Economist complex has been vested with the responsibility of planning and organizing all the seminars and side events preceding the opening of the Board of Governors Meeting. About 9 side events have been programmed and a description of each of these events is provided in the following pages.

3. For Bank organized side events, the Office of the Chief Economist collected, reviewed and compiled the related concept notes to guide the discussions that will take place on the seminars themes.

4. This year, the host country, the Peoples Republic of China in collaboration with the Bank will also organize, other side events including one exhibition and two stand alone seminars to share with the audience the experiences and achievements in Sino African cooperation. In addition and in line with the overall theme of the Ministerial Round Table theme of *Africa-Asia Partnership*, the Japanese government through the Japanese Bank for International Cooperation (JBIC) will also organize a stand alone seminar to share with the audience the Asian experience in promoting Environmental considerations in sustainable development.

5. Each of this Concept Note provide a general guidance to the discussion, providing key issues under each theme and concluding with key questions for consideration by the panelists. The concept notes are deliberately intended to be less exhaustive, but yet set the tone and provide general guidance to the Seminar discussions, without limiting it to the issues raised in the notes. The expectation is that the Seminar would benefit from the wealth of experience and lessons that would be shared by participants, drawn largely from their work in dealing with these issues and challenges in their countries.

1. Background

THEMATIC SEMINAR

THE ROLE OF CORPORATE GOVERNANCE IN PRIVATE SECTOR DEVELOPMENT: EXPLORING PARTNERSHIP AND PRACTICES IN ASIA

Concept Paper

Prepared by: *African Development Bank
The Private Sector Department (OPSM)
Strategy and Development Services Division (OPSM.4)*

Date: *14 May 2007*

Venue: *Europe Hall
Shanghai International Convention Center, Oriental Riverside Hotel*

Time: *7:15 am to 9:00 am*

1.1 Corporate governance is one of the major recent areas of increased interest and intervention in both developed and developing countries, including countries in Asia and Africa. In most recent years, the OECD, in collaboration with the World Bank and AsDB, has played an ever-increasing role in promoting good governance in Asia. Similar efforts also have concerned selected African countries and sub-regions of Africa.

1.2 This derives from the general recognition that good corporate governance promotes efficient, effective, profitable, competitive and sustainable enterprises that contribute to the welfare of society by creating wealth, employment and solutions to emerging challenges. It also enhances transparency and accountability of business; and ensures implementation of the highest standards of corporate responsibility, citizenship and ethics to strengthen mutual social responsibility and enhance the spirit of participatory development.

1.3 Good corporate governance is essential in establishing attractive business environments for investors. Good corporate governance also plays an essential role in mobilizing domestic savings for investment. In increasingly globalized markets good corporate governance helps raise capital, satisfy investors and run successful businesses. Case studies of Argentina, Brazil, Chile, China, India, Malaysia, Philippines, South Africa, Mauritius, Ghana, Zambia and Kenya suggest corporate governance helps increase the flow of financial capital to firms in developing countries.

1.4 Yet, in many African countries, in spite of these benefits, corporate governance still seems to be characterized by poor performance monitoring systems; small and weak capital markets; non-independent boards of directors and auditors. Many countries still face major challenges, in particular: i) ineffective law enforcement due to weak judicial infrastructure. Most countries have appropriate legislation in place but need to institute or strengthen their regulatory bodies with powers to investigate and sanction; ii) lack of transparency, which goes beyond the ultimate / beneficiary share ownership of large companies and may resort in tax evasion or bribery to bypass red tape, fiscal liabilities, etc.; iii) limited accountability even where corporations are by law accountable to shareholders and subject to fines / criminal sanctions or removal for failure to report or comply with corporate formalities and responsibilities; iv) limited awareness of responsibility: many stakeholders are not fully aware of their rights and those who are aware often do not have the capacity to act and sustain demand for responsible behavior by firms.

1.5 Apart from South Africa and Egypt, African markets are still off the radar screen for global investors because of limited accessibility and exclusion from the main indices, such as the Morgan Stanley Capital International (MSCI).

2. Corporate Governance and Entrepreneurship Development

2.1 Noting the corporate governance issues above, it is worthwhile to highlight the uniqueness of the African private sector environment. Much of Africa's economic activity is within the Small Micro and Medium Sized Enterprises (SMME) and informal sectors. SMMEs constitute a major driving force for national economic growth and development, and play an important role in creating jobs, wealth, distributing development and contributing to the social and cultural well-being of countries and the continent as a whole. However, the risk of failure increases substantially in the smallest firms, which in general belong to new entrepreneurs. Because of their size and generally constrained access to financing, SMMEs

are more susceptible to downturns in the economy and structural weaknesses in domestic and global trade, therefore particular attention should be paid to the needs of SMMEs at their early stage of existence.

2.2 To minimize this risk, newly created SMMEs must pay greater attention to corporate governance as part of their internal management processes. Good corporate governance increases the chances for such newly created enterprises to access resources under preferred conditions, increase their life expectancy, and reduce risks of failure. It will also help reducing the informal sector and assist small and even medium-size corporations move from informal to formal activities.

2.3 A thriving private sector is the driver of growth. As African countries move away from state-run enterprises as the dominant instrument of economic performance, and private enterprises become the key vehicles of wealth creation, it is critical that rules and procedures are in place to ensure that those who lead, direct and control companies behave appropriately and in the interest of the broader economy and society.

2.4 Therefore, corporate governance should be considered as both relevant and critical to the whole spectrum of enterprises and within this context to enterprise creation and entrepreneurship development. Efforts in propagating good corporate governance should not focus only on large publicly-listed corporations, state owned enterprises (SOEs), and multinational companies. Efforts must also be concentrated on SMMEs , which in most African countries constitute the greater segment of the private sector in terms of number of participants. In parallel, efforts and incentives should be put in place to encourage companies to become publicly-listed.

3. The Bank's Role and mandate

3.1 In line with its Vision, the Bank developed a policy¹ as well as guidelines on good governance. The policy seeks to encourage RMCs to improve their systems of governance and thereby create an enabling environment for investment, growth with equity and poverty reduction. Corporate governance is one of the components of the Bank's governance policy. In 2005, the Bank adopted a comprehensive corporate governance strategy which serves as a framework for and facilitates Bank activities in this area. The Bank's corporate governance strategy is also consistent with its Private Sector Development Strategy adopted one year earlier. This strategy lays emphasis on the need to promote corporate governance to support entrepreneurship through the development of an enabling environment for the emergence of a viable and sound private sector in RMCs. In the context of NEPAD and the APRM, the Bank has been given the mandate by African Heads of State to play a leadership role in promoting good corporate governance in Africa, including in the area of banking supervision and financial standards.

3.2 Corporate governance is a direct concern to the Bank as an equity investor in private sector ventures and regional banks, and as financier of development projects, the implementation of which often relies on getting private sector corporate and SOEs involved. The successful outcome of such investments and projects clearly depends on compliance of concerned actors with good corporate governance practices.

1 African Development Bank Group Policy on Good Governance, 1999..

3.3 The Bank has a vested interest in helping to create an enabling environment for good corporate governance.. In furtherance of this, the Bank Group provides concessionary loans and grants to RMC's; supports economic reform programs and assists in combating corruption. Through its private sector activities, the Bank directly promotes good corporate governance by linking its support to good management and good governance of beneficiary companies. The Bank also contributes to building the continent's strategic human capacity. One example is its support to the establishment of the African Law Institute, the African Business Roundtable, the Pan-African Corporate Governance Forum, and the African Management Services Company (AMSCO BV).

3.4 From the Bank's perspective, corporate governance goes beyond the shareholders' property rights and the mechanisms of exercising such rights. In the context of Africa, corporate governance or enterprise governance describes all the influences affecting the business institutional processes, including the policies and legal frameworks that society adopts; the mechanisms for appointing the regulators & controllers involved in organizing the production and sale of goods and services. Described in this way, corporate governance applies to all types of firms. Furthermore, the Bank views good corporate governance matters as involving the whole spectrum of ownership structures, including family-owned micro, small and medium enterprises and publicly-owned local entities, including municipalities.

4. The Bank's Corporate Governance Strategy

4.1 The Corporate Governance Strategy represents a way for the Bank to help improve economic governance in African countries, by promoting best practices at the corporate level. The strategy recognizes corporate governance as a bottom-up approach in laying foundations of good governance of African countries. It is intended to guide the Bank in promoting a widespread culture of transparency and accountability in entrepreneurship, which will have positive benefits in the political and institutional environment within which the Bank operates. The Bank recognizes that corporate governance (including corporate social responsibility) helps curtail corruption and preserve the environment.

4.2 The Bank's defines corporate governance in the strategy thus: "*Corporate governance refers to mechanisms that frame the duties and powers of corporations to deliver benefits to those who have invested resources in them and those that are directly impacted by their activities (stakeholders)*". Mechanisms refer to laws, regulations and accepted business practices. Investors include suppliers of equity finance (shareholders), suppliers of debt finance (creditors), suppliers of relatively firm-specific human capital (employees) and direct or indirect suppliers of other tangible and intangible assets that corporations use to operate. Those that are directly impacted are composed of customers and the community in which the corporation/firm operates.

4.3 The Bank strategy aims at promoting the three key governance principles: Transparency, Responsibility and Accountability at the corporate level; and seeks to ensure proper regulatory frameworks and institutional capacities are in place to enforce these principles. The strategy also includes three key components: Standards and norms development; Institutional and human capacity building; and Financial support. These components merge in defining appropriate capacity building interventions in each country where the strategy is applied. The Bank's efforts to improve corporate governance target three key players: i) governmental organizations and regional institutions (in particular the

regional economic communities - RECs); ii) financial intermediaries; and iii) corporations, particularly SOEs and SMEs.

4.4 Operationally, at the country level, standards and norms will be developed and aligned to existing international guidelines, which already have been adopted by African Heads of State in the context of NEPAD and the APRM implementation guidelines. The Bank will use its policy-based loans to assist countries to adopt, upgrade and adjust their legal and institutional framework. In particular, benchmarks will be adopted to better guide Policy-based lending implementation and assessments. Extended assistance will be based on the specific needs identified in each country. At the corporate level, the Bank will use its resources to assist financial institutions and individual firms including banks, to improve their standards of corporate governance. The Bank will engage financial intermediaries in promoting corporate governance, by setting conditions consistent with good corporate governance principles in the use of resources made available to them, including in the form of codes of conduct. It also will provide better conditions for access to its resources for corporations, which can prove that they have embarked on improving corporate governance. Where feasible, the Bank will promote actions and programs that are regionally designed and oriented.

4.5 More generally, the Bank will assist existing regional mechanisms (such as OHADA) and institutions (such as the Centre for Corporate Governance of Nairobi, ECSAFA and AMSCO) to help improve corporate governance practices in African countries. It will encourage countries to adopt and adjust existing instruments and codes instead of producing new ones. The Bank intends to assist RMCs (governments and key players) in close cooperation with NEPAD and RECs to develop their codes of corporate governance and apply them.

4.6 The above strategic orientation will be achieved through financial support and technical assistance to governments. The Bank intends to partner with financial intermediaries, in particular with banks (including micro-finance institutions) to provide preferred financial conditions to enterprises that are committed to champion corporate governance good practices.

5. Partnership and implementation of the Bank's Corporate Governance Strategy

The Bank is already conducting systematic due diligence exercises to ensure full compliance with corporate governance principles of the partners involved in projects that the Bank is supporting. The Bank is also providing direct assistance to local investors to endorse CG principals to become eligible for Bank financial support. In particular, the Bank (through its private sector window) had accompanied several regional development financial institutions as well as local banks, in their efforts to comply with CG principles. The Bank has also suspended disbursements to non-compliant corporations.

The Bank hosted its first Stakeholders and Development Partners Consultative Meeting on corporate governance from 08 and 09 December 2006. This Meeting was devoted to reviewing the current status of Corporate Governance in Africa and determining the best modalities for implementing the Bank's Corporate Governance Strategy. The Meeting took into account on-going programs and activities in the continent, developed by other partners and stakeholders.

The Meeting called for strong partnerships and collaboration among all stakeholders in the implementation of the Bank strategy. Significantly noteworthy was the call by participants on the Bank to organize international gatherings that build on the experience of other regions in the world as well as on success stories in Africa.

Several organizations are currently working at promoting good corporate governance on the continent. In addition to institutions such as the Commonwealth Secretariat, the Organization for Economic Cooperation and Development, the Global Corporate Governance Forum, and the United Nations Global Compact, some African bodies are actively promoting good governance in the African corporate world. These African bodies include the Center for Corporate Governance and the Pan African Consultative Forum for Corporate Governance; The Bank wishes to build on its continental leadership, to engage a constructive dialogue with these institutions in order to develop joint programs of actions to promote good corporate governance at continental level.

6. Partnering with Asia in Promoting Corporate Governance

6.1 Africa should adapt good corporate governance practices from Asia, particularly best practices from China, India, Malaysia and Korea. The objective, among other reasons, would be to reverse the persistent trend of exporting raw materials (crops and minerals) without adding value, while manufactured consumer products are imported in Africa. China offers a good example of partnership that leverages the complementary roles of the State and development banks in promoting good corporate governance among newly created SMEs. Asia and Africa present several similarities. In both continents, family-owned and small businesses are predominant and the relationships among stakeholders remain largely informal. A number of legal and regulatory frameworks exist in both continents. With these similarities, there is scope for Africa to learn from Asia's experiences.

6.2 However, the business environment and investment climate in Africa are still not attractive enough to both local and foreign operators. The major reasons are lack of transparency of firms and shortcomings in the regulatory frameworks. That is one of the reasons why in Africa, more than in Asia, firms (mainly SMEs) face strong credit constraints and have little recourse to financial markets (including stock markets) to raise funds. Firms tend to use mostly internal finance and cash flows to support their growth.

6.3 Within this context African private sector will not be able to play the role of engine in promoting sustainable growth; and entrepreneurship development will remain marginal and will not contribute to lay solid foundations to achieving the ultimate MDGs.

6.4 Increasing transparency in reporting and accountability by smaller firms might be particularly beneficial to financial markets development and growth of external financing. But it needs to be part of global reform that build on strengthening good corporate governance from an overall perspective. Asia, in particular countries such as China and India have made significant progress in that direction; and institutions such as the AsDB, GCGF and COMSEC have played a big role in promoting needed changes. It is expected that the Seminar would facilitate the sharing of these positive lessons from Asia with African partners.

7. Discussion for Seminar

7.1 The Seminar will offer African and Asian partners an opportunity to review their roles and identify best practices and approaches to promote corporate governance, paying particular attention to success stories such as the joint-venture story of the African Management Services Company BV (AMSCO BV). In this context we have developed the following questions to guide the discussions of the Seminar:

- How can the partnership between Africa and Asia be used to improve the business environment and the investment climate in Africa?
- What are the best practices and lessons that Africa can learn from Asia on the role of corporate governance in entrepreneurship development and attracting investments?
- How can the role of the Bank be structured in promoting the Africa-Asia partnership as a mechanism for improving the business environment and entrepreneurship development in Africa?

Abstract

THEMATIC SEMINAR

**FRAGILE STATES AND
THE ROLE OF EXTRACTIVE INDUSTRIES IN AFRICA**

Concept Paper

Prepared by: *Governance, Economic and Financial Management Department
(OSGE), African Development*

Date: *14 May 2007*

Venue: *Huagpu River Hall
Shanghai International Convention Center, Oriental Riverside Hotel*

Time: *2:30 pm to 4:30 pm*

1. Africa is the continent with the largest concentration of fragile states in the World. Whatever the definition of fragile states, it is clear that a significant number of countries, particularly in sub-Saharan Africa are characterized by weak human and institutional capacities, poor governance structures, political instability, and corruption. In addition, such countries are also often conflict-prone. At the same time, Africa is very rich with extractive resources. The continent is currently facing promising prospects in the discovery, exploration, and potential production of extractive resources, combined with a peak in commodity prices. A new “resource boom” may be underway, with new petroleum resources coming in the pipeline in a number of African countries. Handled well, in a positive scenario, this can lead to broad-based growth and poverty reduction in Africa.

2. However, research and analysis suggests that there is a clear positive correlation between fragility and extractive industries. Discovery of such resources may not in itself lead to political instability or conflict, but it can contribute to worsening existing tensions, lead to deterioration in governance, prolong crises, and not least create conditions for the start, resumption or fueling of existing conflicts. In a worst-case scenario a number of new fragile states may be the result, with very serious consequences for Africa’s development. Failing states have a dampening effect on the economies in their regions, and can rapidly undo years of steady development. Not only African countries and the continent as a whole, but also international investors will be badly affected if such worst case scenarios become a reality.

3. Therefore, a comprehensive and coherent strategy—based on lessons of experience—is necessary to help stabilize countries in fragile situations, prevent new resource rich countries from becoming fragile due to mismanagement of their extractive resources, and enable them to use their resource revenues for sustainable development. Such a strategy must focus on combining efforts to assist fragile states in rebuilding state capacity, including improving governance through strengthening management of extractive resources in resource rich countries. If the positive scenarios are to become the reality for Africa, all relevant actors need to be included in such a process, IFIs and donors, private sector and civil society, and not least – the new investors on the African continent, countries like China and India.

1. Introduction

1.1 There is growing consensus in the international community of the importance of engaging effectively in fragile states² and situations. Fragile states today account for almost a third of the developing countries' poorest population and a majority of this population is in Africa. Though the overall economic performance in Africa has been improving, especially over the past three years, due partly to improved international commodity prices of exports, a large number of countries remain trapped in debilitating poverty situations. Based on estimates undertaken by the African Development Bank³, about half of the countries of Africa – 25 countries out of 53 - may be defined as fragile and nearly two-thirds of the African's population or around 495 million people, live in these countries. In addition, many other countries in Africa run the risk of becoming fragile states. The Bank's estimates are in line with those of other partners⁴. These countries represent a significant part of the challenge in meeting the MDGs.

1.2 State fragility generates externalities that go well beyond the countries themselves. As firmly documented, instability amongst fragile states has major spill-over effects that undermine prospects for regional stability, ultimately affecting the global community. The direct effects are particularly harsh on neighboring countries and sub-regions. When countries are in conflict over half the costs are borne by neighboring states. Investment in preventing states from falling into fragility is needed. Even in the absence of conflict, failing states have a dampening effect on the economies in their regions, and can rapidly undo years of slow but steady development⁵. Recent analysis by the World Bank suggests that on average, economic growth is reduced by 0.4 percent per annum if a neighboring country is fragile.

1.3 To have a positive impact on Africa, promote regional integration, and boost growth, international donors have to engage with fragile states. Indeed, as part of a commitment to the African region, non-engagement is simply not an option. The key questions are thus how best to engage. This is particularly important when it comes to countries with extractive resources, where poor management leads to what often is referred to as "the resource curse". International donors have tended to shy away from both fragile states and resource rich

² There is as yet no common definition of fragile states. Various partners define fragile states in different ways, leading them to focus on varying group of countries. For example, some characterize fragile states as those with poor policies, institutions and governance structures. Others use poor socioeconomic indicators as a criteria for determining state fragility, while other still use indicators relating to the political environment and security to define fragility.

³ The AfDB defines fragile states based on a country's performance on the Country Policy and Institutional Assessment (CPIA) rating and the Country Vulnerability Index (CVI) which is a weighted index of various measures of vulnerability such as UNDP's Human Development Index, high dependence on primary commodities, and exposure to frequent natural disasters. Countries with aggregate CPIA ratings of less than 3.0 (in a scale of 1 (low) to 6 (high), along with the CVI of less than 0.351 (in a scale of 0.00 (low) and 1.00 (high) have been classified as fragile states. Using the 2005 CPIA and CVI ratings, the AfDB has identified a group of 25 African countries as fragile. Of the twenty five, sixteen have been isolated as the core fragile states.

⁴ The World Bank, in fiscal year 2006, identifies 16 African countries as fragile. These are African countries with a gross national income per capita that falls within the threshold of IDA eligibility and a performance of less than 3.0 or less on both the CPIA rating and the CPIA for Public Sector Management and Institutions.

⁵ Recent analysis by the World Bank suggests that on average, economic growth is reduced by 0.4 percent per annum if a neighbouring country is fragile.

developing countries. In many cases these features occur in the same countries, thus making them prone to instability and conflict.

1.4 The international community, including multilateral development banks and other partner institutions and agencies, have been grappling with issues of how best to provide effective development assistance to fragile states and are increasingly addressing these challenges. The World Bank has focused on “Low-Income Countries Under Stress” and has developed specific guidance on country assistance strategies, development policy operations, and transitional result frameworks in fragile states. Its experience so far points to four main lessons for improving future effectiveness in fragile states: (i) well-sequenced reforms spanning a sufficient number of years are necessary for achieving results without overwhelming limited fragile states capacity; (ii) the focus from early days needs to be on the development of capacity and improvement of governance—not merely the reconstruction of physical infrastructure; (iii) there is need to develop transparent aid allocation criteria for fragile states that ensure that these countries are not under- or over-aided; and (iv) given the constantly changing and volatile environment in most fragile states, performance needs to be closely tracked in order to determine *when* and *what kind of* adaptation is necessary.⁶ The AfDB, is in the process of developing a new operational strategy for enhancing its assistance to fragile regional member states. Most of these approaches do not so far capture adequately the linkage between state fragility and extractive industries. A categorization of countries in “fragile and resource rich” may be an interesting and important exercise. In this context, however, our main interest is to analyze the linkages and look at trends rather than classify countries.

1.5 Addressing state fragility more broadly while simultaneously tackling the specific problems created by the extractive industries will be critical to ensure sustainable development in Africa. One without the other will only yield temporary solutions. For example, if wide-spread poverty and conflicts persist in a country, any solution that is narrowly focused on managing extractive industries is likely to prove ineffective in the long term. On the other hand, reduction in poverty and conflicts will not, in and of themselves, stop specific groups of the population from seeking rents from extractive industries. This Concept Note analyses the link between state fragility and the resource endowments of a country in the context of extractive industries. The paper then elaborates on some specific problems created by extractive industries in fragile states and provides suggestions for the way forward in tackling some of these issues.

2. Fragile States and Extractive Industries: Two sides of the same coin?

2.1 State fragility and the extractive industries represent in many contexts two sides of the same coin. Very few countries in Africa have managed their extractive industries in a way that benefits the majority of the population and their future generations. A few exceptional cases in this regard, include Botswana, Namibia, and South-Africa that have implemented, over the years, solid economic reforms aimed at managing the proceeds and utilization of resources that accrues from the extractive industries.

2.2 In many cases, the income from extractive industries seems to end up in the hands of the few, with limited visible benefits for the poor population in the country concerned. While

⁶ For a fuller discussion of these lessons, see “Engaging with Fragile States: An IEG Review of World Bank Support to Low-Income Countries Under Stress”, Independent Evaluation Group (IEG), World Bank, 2006.

stability seems to be the characteristic of countries that have managed the utilization of their resources well, fragility and instability seem to be the tendency in countries with poor resource management. Many African countries are now discovering new and exploitable extractive resources. A “resource boom” may be underway, with new potential resource rich countries coming in the pipeline both in West and East Africa. In this regard it is urgent to focus on the inter-linkages between the management of extractive industries and fragility, not least for preventive reasons.

2.3 Extractive industries are seldom the reason for unrest and war in a country. It is the way these resources are managed that can exacerbate an already tense situation, be the factor that sparks an already brewing conflict, lead to a scramble for political power domestically and create instability and volatility. Similarly, if there is ethnic tension, the potential for unrest is prevalent. Where there is violent conflict, the scramble for territorial control over extractive resources often worsens the situation. With such control, for example by rebel movements, extractive resources finance and fuel these conflicts.⁷ Countries like Sierra Leone, Liberia, and the Democratic Republic of Congo are examples of this. The economic incentive is often to retain this territorial control through war, rather than to risk an uncertain peace. A number of African countries have, despite these factors, succeeded in negotiating peace agreements during the last decade. These post-conflict countries are in a high-risk situation, where they can easily lapse back into instability. To stabilize the situation in these post-conflict countries, sound management of extractive industries is critical. Here, neighboring states and the sub-region also play pivotal roles, as do international investors and donors. A comprehensive strategy is needed to address these challenges. This is critical also for the new resource rich countries on the continent.

3. Challenge for Africa in Managing Extractive Resources

3.1 We have shown that there is the link between being resource rich in Africa and fragility. The existence of extractive industries has a fantastic economic potential, but it also entails a high risk environment for Africa’s development. These resources, if well managed, could significantly assist in turnaround the economic prospects of these countries. They could serve as the continent’s springboard to broad-based economic growth, industrialization and poverty reduction. However, should the wrong choices be made both by governments, international actors and investors, serious consequences will be the result, potentially retarding the continent’s future progress.

3.2 We may see several scenarios for Africa:

- *The Positive Scenario*: Well managed development and utilization of extractive resources in a number of new countries, with broad based growth and successful pro-poor policies in Africa;
- *The Mixed Bag Scenario*: Some of the new resource rich African countries succeed in getting it right, others end up with bad management, significant corruption problems, and potential instability and conflict;

⁷ Collier, Paul and Anke Hoeffler: *Greed and grievances in civil war*, Oxford Economic Papers, Vol 56 (4), pp. 563-595, 2004.

- *The Worst Case Scenario:* Almost all the new resource rich African countries end up with mismanagement, significant corruption, low growth, no poverty reduction, and the enrichment of the few. In this scenario, new conflicts may erupt, the consequences not being limited to the countries themselves, but the spill-over effects of fragility will also affect the sub-region negatively.

3.3 The Positive Scenario should be the ambition of all actors, reaping the benefits of the resources for the countries and the continent. If African countries end up in the Mixed Bag Scenario, and even the Worst Case Scenario, there will be serious consequences most of all for the continent itself, but development actors, private investors, and new global actors such as China and India will also suffer. As for international investors, the consequences will not only amount to the potential loss of the investment itself, but also to reduced access to additional resources. The possibilities for expansion in investment will be curtailed. Based on the foregoing, it is critical that the African governments get it right, both in terms of the production and revenue management and resource allocation side. In the following, we will examine what needs to be done in both these areas:

Getting it right in production and resource management: Ensuring sustainable resource utilization

3.4 *Enabling Environment and Sound Resource Management:* Key to successful exploration of extractive resources is the creation of an enabling environment for the extractive industries that encourages wealth formation without compromising environmental, social, and cultural considerations. Reform concepts should be translated into extractive resource laws, regulations, contracts, and institutions that promote foreign and domestic direct investment and competition. For some countries, this implies that the current generation of extractive resource laws and regulations must be reviewed and contracts be established that benefit host governments and support future exploration and production. The development of sound legal and regulatory frameworks to govern extractive resource exploration and production and the establishment of effective administration and supervisory mechanisms are critical. Similarly, resource databases for optimal planning and extraction of extractive resources need to be developed. New contractual arrangements and legal instruments must also be developed to improve local content of extractive resource harvesting.

3.5 *Environmental and Social Standards:* Environmental and social concerns associated with the exploitation of extractive resources are crucial to the viability and sustainability of the process.. Consequently, policies should address both the environmental management capacity within the sector and basic legislation, rules, and regulations covering environmental dimensions of extractive resource sector management. This includes environmental and social impact assessments.

3.6 *Building Capacity:* Capacity constraints in fragile states are of serious concern, particularly related to the management of extractive industries. The extractive resources sector is complex and requires very high-level technical and managerial capacity. This capacity is lacking in all African countries, including those that have been exploiting minerals for over 30 years. As a result, there is little, if any, real domestic involvement in the sector. The dominance of multinational companies with much capacity and experience creates an imbalance in relation to all up-stream activities. The challenge of building up domestic extractive resource management capacity requires strengthening of governance systems,

building organizational and institutional capacity in sector ministries, in the ministries of finance and planning, and in local governments, in all the areas mentioned above.

Getting it right in the management of revenues: Preventing fragility – creating broad based economic growth

3.7 ***Macroeconomic Management:*** The failure of many African countries to harness their extractive resource wealth for poverty reduction, economic growth, and progress towards the MDG targets is often due to a lack of macroeconomic strategies. Resources from extractive industries often make up a major part of government revenue. However, many countries do not have policies in place that promote and encourage judicious and sequential exploitation and management of these resources and attenuate the boom and bust effects of extractive resources wealth. The development of expenditure frameworks aligned with country development priorities is an important tool, incorporating revenues into public expenditure programs within a coherent macroeconomic, fiscal, and sectoral framework. In addition, better management of unexpected windfalls for example through a stabilization fund, would insulate economic activity from fluctuations in commodity prices as well as encourage fiscal discipline. Fair revenue distribution must be ensured by providing basic social services for the population at large. There is also an immediate need to implement pro-poor policies related to a disciplined administration, increase the use of local content in the industry concerned, and diversify the economy. The exploitation of extractive resources could also contribute to local economic development through the provision of basic infrastructure such as roads, power grids, and dedicated ports and social services such as water, health, and education.

3.8 ***Transparency and Accountability:*** The important role of extractive resources for government financing has often retarded political development, with a lack of incentive to collect taxes, rendering it unaccountable to its constituencies, and significant corruption. Hence, to promote equity and fair distribution of benefits, there is a need to enhance transparency, accountability, over-sight, and monitoring in the management of revenue flows and decentralization of revenue sharing. This should be done e.g., by adhering to international standards for the verification and full publication of company payments and government revenues from oil, gas, and mining. By making information public, the possibilities for corruption and mismanagement are reduced. The endorsement of the Extractive Industries Transparency Initiative (EITI) by more than twenty resource rich developing countries need to be followed up by implementation at the country level, and further expansion of transparency standards. In addition, making information about disposable income available to the public creates a demand for the efficient and equitable use of these resources among all segments of the population, including civil society.

Getting it right: the role the international investors and actors can play

3.9 For African countries to get it right – in terms of management of extractive industries – all actors have critical roles to play.

3.10 ***International donors:*** International donors have for a long time largely avoided the difficult environments of the resource rich developing countries and in many cases also fragile states. The international financial institutions (IFIs) have engaged, but with marginal success. Disengagement may, in fact, be the most costly of all. As new resources are discovered in Africa, and new resource rich countries are in the pipeline, the role of the

international community is all the more critical. Assisting countries to avoid the pitfalls of what has been called the “resource curse”, strengthening transparent and good management of extractive resources, and sharing revenues through pro-poor policies will be key. Here, rapid response is of the essence. Donors should enhance their engagement through e.g.:

- Adhering to the agreed *Principles of Good International Engagement Fragile States* through coordination at headquarters and in countries. These principles are key to succeed with any donor interventions in fragile states, including resource rich countries;
- Investing in *strengthening the capacity* of resource rich governments in the process of discovery, exploration, extraction, and production of extractive resources; ensuring gradually and nationally owned extraction-processes; and respecting environmental and social standards;
- Investing in *strengthening the revenue systems of resource rich countries, ensuring full transparency and accountability*, enforcing strong public financial management systems, creating savings funds, sharing revenues, and ensuring investment basic services for the population. Assisting countries in implementing the EITI-principles at the country level will be critical;
- Ensuring that all interventions are *tailor-made, adapting to the often rapidly changing environment* in each resource rich and fragile country, and in their implementation use more speedy procedures and processes to build the necessary capacity and regulatory framework in time.

3.11 *Emerging donors and new investors*: It is critical that the new and emerging donors and investors like China, India and South-Africa (the latter being by far the largest investor on the continent) are engaged in this process. If transparency is required from these investors, adherence to sound and transparent financial management standards would be a lot easier. A comprehensive dialogue could be based on the Principles for Engagement in Fragile States, global instruments such as the UN Convention against Corruption, and initiatives such as the EITI.

3.12 *Private and Publicly Owned Companies*: Domestic and international companies have a commercial as well as moral role to play, not least given the central position of the private sector in extraction of natural resources. Companies need to move beyond strategies of compliance and risk minimization. Their goal should be to pursue strategies of pro-active, systematic value addition, aimed at creating positive value for as many stakeholders as possible. An increasing number of extractive companies should implement standards of Corporate Social Responsibility and transparency through EITI.

3.13 *Coalitions*: The role of coalitions for change in the management of extractive resources has become increasingly important during the last couple of years. The growing movements of the EITI and the Kimberly Process consisting of industry, governments and civil society, are encouraging and should be supported by the international community, including emerging global actors such as India and China. Implementing EITI as part of a program of improved governance helps to ensure that resources are not diverted and instead contribute to sustainable development and poverty reduction. As the EITI covers only revenue transparency, expanding the Initiative to include transparency in both production and process (such as applied in Nigeria) – a so called EITI Plus – would make the instrument

considerably more powerful. In addition, there may be a need to address upstream and downstream issues such as licensing, ownership, environmental stewardship etc.

3.14 Kimberley Process participants currently account for well over 99 percent of the global production of rough diamonds. Today, 71 governments, in partnership with the diamond industry and NGOs, are committed and legally bound to the UN-mandated process. In principle, the Certification Scheme could be extended to other minerals such as gold, coltan, tantalum, etc. in order to break the link between conflict and extractive resources. With regards to fragile states, enforcement of these kinds of tools are crucial to maintaining peace, hence the need for more coercive measures. These types of coalitions or partnerships between international actors, donors, companies, countries and civil societies have achieved a lot the last few years.

4. The Way Forward

4.1 The future of Africa with regard to economic growth and reaching the MDGs will to a large degree be decided on the basis of the developments in its fragile states and in extractive industries – both individually and in combination. As the combination may occur more frequently in the next few years, it is critical that international donors and IFIs, industry, and civil society work together to assist African governments, help them succeed on the management side, and encourage that the right choices with regard to transparency are made as outlined above. Whether the negative or positive scenarios will prevail will largely be the result of key leadership decisions and collective responsibility. As for the latter all actors have important roles to play. Africa's development may depend on it.

4.2 This Concept Note brings out the strong inter-linkage between state fragility and poor governance, in the context of a country's inability to effectively use resources from extractive industries for equitable and sustainable economic development. Past experiences show that such resources have contributed to worsening socio-economic development, increased corruption and political instability in a number of African countries. This untenable situation is likely to continue, as more countries discover exploitable natural resources unless comprehensive and coherent reforms, focused on improving economic and political governance are implemented.

4.3 In this regard, we develop the following key questions for discussion by the panelists:

- What are the linkages between state fragility, as currently defined, and poor economic and political governance, particularly in countries with extractive industries?
- What is the role of development partners and the wider international community in addressing state fragility and poor governance at country level?
- Why have past efforts by development partners and the international community, particularly with respect to some mineral deposits and crude oil generally failed in ensuring that such resources are used by countries for promoting equitable and sustainable socio-economic development?
- What package of reforms and policies, based on past lessons and experiences, from Asia could African countries implement in order to ensure that resources from extractive industries are used for the benefit of a country's citizenry?

- What could be the role of Asian development partners and the wider international community in designing, developing and even implementing such package of reforms and policies at country level?
- How does improving a country's capacity in economic management assist in the effective management of extractive resources?
- Is a holistic and long-term approach encompassing the wider state building the answer in ensuring appropriate management of resources from extractive industries in Africa?
- What possible roles can other stakeholders – civil society groups, non-governmental organizations and the private sector (especially in Asia) – in ensuring that resources from extractive industries are used for the benefit of the country?

Abstract

THEMATIC SEMINAR

**CLIMATE CHANGE
AND
THE CHALLENGE FOR DEVELOPMENT**

Concept Paper

Prepared by: *Operations Policy and Compliance Department (ORPC)
Sustainable Development Division (ORPC.2)*

Date: *14 May 2007*

Venue: *Auditorium
Shanghai International Convention Center, Oriental Riverside Hotel*

Time: *2:30 pm to 4:30 pm*

1. The international community has now reached a consensus on the fact that increasing emissions of greenhouse gases like carbon dioxide and methane - most of which are linked to the human use of fossil fuels - are causing changes in the global climate systems. Climate change currently poses one of the greatest risks to environmental, social and economic development in both the developed and developing world and its direct and indirect impacts threaten to reverse decades of development efforts.

2. In Africa, climate change is already having profound and irreversible impacts on the continent's economic, social and environmental systems. This is increasingly apparent from the frequency and intensity in the occurrence of natural imbalances and climate related disasters on the continent, including recurrent droughts, floods, erratic rainfalls, and other similar extreme weather events that threaten human health and infrastructure; agriculture production and food security, water, land and other natural resources sustainability that are key to human survival and economic development.

3. While there are opportunities to introduce clean energy in Africa, it is more urgent to introduce adaptation to climate change, because climate change affects and threatens natural resources conservation and their sustainable use. Agriculture, fisheries, livestock, water, tourism, natural parks and coastal resources are directly impacted by climate change with the dire consequences of more hunger and increased poverty. It is possible to reduce poverty while at the same time strengthening the capacity of those living in poverty to adapt to climate change. The seminar will focus on the following issues:

- Issues, challenges and opportunities related to promoting low-carbon development. How to finance it, how to mainstream it in the development assistance and Asia-Africa cooperation, including technology transfer and carbon trading;
- Issues, challenges and opportunities related to climate adaptation. How to support climate risk management, how to finance it and how to mainstream it in development assistance;
- The role of the Governments, Financial Institutions, Donors and Private Sector; and
- Bridging the financial gap with existing and/or new financial instruments: the specific challenges for African countries;

1. Introduction

1.1 Climate Change (CC) is emerging as perhaps the most important international development challenge of the 21st century. The economic and social welfare of our societies and indeed their long term sustainability is increasingly vulnerable to CC risks. The recently published IPCC⁸ report⁹ unequivocally concludes that there is a “very high confidence”¹⁰ on the fact that increased emissions of Green House Gases (GHG) like carbon dioxide (CO₂) are of human origin. Developing countries are the most vulnerable and bear the highest risks on their natural resources (NR) as CC and climate variability critically jeopardize their economic development and poverty reduction achievements. Direct and indirect impacts of CC threaten to reverse decades of development efforts. To address these risks, CC issues and response strategies need to be integrated into the overall development agenda. The Stern Review¹¹ concludes that there is still time to avoid the worst impact of CC. However, delaying the response to CC for too long might increase economic losses up to 20% of global GDP¹². In contrast, the costs of removing most of the Climate Change risks are around 1% of global GDP per year if we decisively start acting now.

Key Message: Climate Change in Africa

1.2 Impacts of CC are inequitable. Poor countries are hardest and earliest, while it is the rich countries that are responsible for three quarters of GHG emissions¹³. Africa is particularly vulnerable to CC because of various factors, such as widespread poverty, the unsustainable use of NR, over-dependence on rain fed agriculture, and weak governance structures. Africa is steadily warming, climate is changing, and models predict further warming and further changes in rainfall patterns. The continent as a whole is warmer by 0.5°C than it was 100 years ago.

1.3 Climate change is already having profound and irreversible impacts on the African continent. Main impacts include, among others: (a) increased frequency of natural disasters, droughts, floods and other weather extremes that lead to loss of lives, economic disruption, social unrest and forced migration as well as major environmental problems; (b) sea level rise and flooding that threaten agriculture, human health, infrastructure, particularly in coastal cities and islands; (c) prolonged drought periods that cause stress on water resources and reduced food security due to diminished agricultural productivity; (d) increase in outbreaks of vector borne diseases and other health impacts; and (e) various threats to forestry, water resources, biodiversity, and other natural resources.

⁸ Intergovernmental Panel on Climate Change (2007)

⁹ IPCC (2007). "Climate Change 2007, the Fourth Assessment Report. Volume 1: The Physical Science Basis" concludes: "The understanding of anthropogenic warming and cooling influences on climate has improved since the Third Assessment Report (TAR), leading to very high confidence [*at least a 9 out of 10 chance of being correct*] that the globally averaged net effect of human activities since 1750 has been one of warming"

¹⁰ Ibidem (footnote 2)

¹¹ Stern, N. (2006). Stern review on the economics of Climate Change

¹² With the possibility that the opportunity to stabilize carbon dioxide emissions might slip away all together

¹³ Africa, for instance, represents only a small fraction, 3.6%, out of the total carbon dioxide (CO₂) emissions per year, yet 14% of the population of the world lives here.

1.4 Key sectors such as agriculture, fisheries, forestry, industry, energy and transport are very sensitive to climate change. Natural disasters destroy strategic national investments in infrastructure while there is lack of requisite insurance to cover the losses. It is estimated that the cost of disasters over the next 20 years will be from 6 to 10 trillion US\$ i.e. ten times predicted aid flows¹⁴. Sea level rise is causing enhanced soil erosion, loss of productive land, increased risks of storm surges, reduced resilience of coastal ecosystems and the attendant costs of responding to and adapting to these shocks. Small Island developing countries in Africa are particularly vulnerable. Climate change will also negatively affect coral reefs and more generally key ecosystems.

The Response by the International Community

1.5 Climate change is the greatest market failure the world has ever seen. Three sets of policies are being developed at international level to effectively address this failure by establishing:

- a. Cap-and-Trade policies on carbon pricing, taxation, emissions trading and regulation, so that people are faced with the full socio-economic costs of their actions.
- b. Policies to promote homegrown technological solutions and incentives that will drive the development and deployment of a wide range of low-carbon and high-efficiency products and services.
- c. Policy measures to remove barriers to energy efficiency, and to inform, educate and persuade individuals about what they can do to respond to CC in each sector of the economy.

1.6 Effective action requires a global policy response, guided by a common international understanding of the long-term goals for climate policy and strong frameworks for co-operation. Addressing CC typically involves two types of actions: (a) *mitigation*, by reducing GHG emissions, i.e. investing in a low carbon economic development path and (b) *adaptation*, by “climate proofing” economies i.e. increasingly ensuring the development of climate resilient societies.

2. Key Responses to Climate Change: Mitigation and Adaptation

Mitigation: Reducing Greenhouse Gases While Increasing Energy Access

2.1 Mitigation efforts primarily focus on reducing and avoiding GHG emissions. Mitigation looks into the efficient use of fossil based energy sources (energy efficiency) and at deploying cleaner energy sources (typically renewable energy sources). In Africa, agriculture and natural resources are key to food security and energy is key to economic development and MDGs’ achievement. Improving and at least maintaining agriculture production and expanding energy access, especially to the poor, are thus development priorities for African countries. At the same time, Africa cannot afford to miss the opportunity to follow a low carbon path whenever this option is affordable and economically efficient. Striking the right balance between broadening energy access, managing sustainably NR and reducing GDP energy intensity is the way forward for the African continent.

¹⁴ International Federation of Red Cross and Red Crescent Societies, World Disasters Report, 2001

Increased use of flexible mechanisms under the UNFCCC Kyoto Protocol (in particular the Clean Development Mechanism) is also crucial avenue for Africa.

2.2 Under the UNFCCC, countries in Africa are encouraged to promote clean energy technologies in response to their specific energy needs. By doing so African countries will move towards meeting their energy and wider socio-economic objectives while at the same time reducing GHG emissions per unit of GDP. Energy is central to the provision of services that include cooking, transportation, space heating and cooling, illumination and is central to economic services that include agriculture, industry etc. Although no MDG is specifically focused on energy, there is consensus in the development community that the MDGs will not be met without addressing the energy challenges faced by most developing countries.

2.3 Key energy challenges in Africa are basically the lack of access to modern energy services, potentially available but undeveloped resources and poor policy and regulatory frameworks. As a result, the engagement of African countries in the UNFCCC process, the Kyoto protocol and efforts towards shifting to low-carbon economies should be viewed within an integrated approach that aims at addressing key development goals through the achievement of energy sector objectives (expanded energy access) while at the same time responding to climate change by limiting greenhouse gas emissions per unit of GDP. Key required actions in Africa include:

- Improving institutional, regulatory and policy frameworks to speed up both public and private sector investments in harnessing available energy resources and promoting increased market penetration of renewable energy sources.
- Supporting the commercial dissemination of renewable energy technologies such as wind energy, solar energy (photovoltaic and thermal), biomass energy, geothermal and large and small hydro. As a result, there is need to ensure that national policies and development strategies identify, where and when applicable, renewable energy as a viable option in such areas.
- Widening access to cleaner fossil fuels: Africa has vast resources of fossil fuel resources such as coal, oil and gas that are not fully utilized. The key challenge here is their clean development and utilization through clean technologies.
- Supporting investments in energy efficiency and conservation, with high economic and environmental benefits, with a reasonably short payback period. It is crucial to use all possible opportunities in the different energy uses – residential, industrial, transport – for all feasible energy efficient investment in Africa.

Adaptation to Climate Change to Increase Resilience

2.4 Adaptation to CC and its associated climate variability is the other development priority to address CC in Africa. It is possible to reduce poverty while at the same time strengthening the capacity of those living in poverty to adapt to CC. Africa in particular is considered the continent most at risk by the UNFCCC. This is due to Africa's very large economic role played in highly climate sensitive sectors such as agriculture and fisheries and its current limited human, institutional and financial capacities to anticipate and respond to the effects of climate change.

2.5 Adaptation to climate change and its associated variability is therefore a development priority in Africa. It is possible to reduce poverty while at the same time strengthening the

capacity of those living in poverty to adapt to climate change. The best way to address current and future climate change and variability impacts on the poor is by integrating climate risk management measures into strategies and programs. In this way, developing countries will “climate proof” their development efforts. Only such a comprehensive approach, which provides options for poor people to reduce their vulnerability to current and future risks, will contribute towards achieving the MDGs and ensure that sustainable progress is made beyond 2015.

2.6 Efforts to adapt to climate change will have to be focused on a number of priority areas such as education, good governance, human resources development and training, institutional capacity building and management change, public finance improvement, and natural resource management. Effective information sharing especially on best adaptation practices and lessons learnt and transfer of appropriate technologies will also be crucial elements. Progress in these areas will build the resilience of countries, communities, and households to all types of shocks, including climate change and climate variability impacts. To achieve substantive progress in the field of adaptation in Africa there is a need to focus activities on the following priorities:

- Promoting vulnerability assessments and climate adaptation strategies that fully address the different dimensions and root causes of poverty including gender inequality.
- Promoting mainstreaming of climate issues into key national, sub-national, local and sectoral development planning processes, such as Poverty Reduction Strategies (PRS) or national and local strategies for sustainable development.
- Ensuring that development programs and projects are designed to minimize climate change and variability risks; and mainstreaming climate risk management and climate adaptation approaches into ODA operations.
- Increasing access to good quality information about risks and impacts of climate change and variability. Early warning and information distribution systems help to anticipate and prevent disasters. Improving local forecasts and flood and droughts emergency preparedness will also assist in achieving higher development outcomes.
- It is key to empower communities to participate in climate change vulnerability assessments and feed in their knowledge to provide useful climate-poverty information. Communities will also need full access to climate relevant information systems.
- Increasing the resilience of livelihoods and infrastructure as a key component of effective poverty reduction strategies. Similarly, effective adaptation strategies should build upon, and sustain, existing livelihoods and thus take into account existing knowledge and coping strategies of the poor.
- Traditional risk sharing mechanisms, such as asset pooling and kinship, could be complemented by climate specific insurance schemes and micro-insurance approaches. Infrastructure design and investment, both private and public sector, should take into account the potential impacts of long term climate change and increased climate variability.

3. ADB: Role and Comparative Advantage

3.1 The Bank will refocus its instruments and policies to deliver sustainable, reliable and environmentally friendly energy through replicable and up-scalable mechanisms to promote the exploitation of available natural resources and energy resources (renewable and non-renewable); widening energy access for poverty reduction; mobilizing additional financial resources; capacity building; strengthening strategic partnerships and synergies. At the same time, there is a need for an increased focus on climate change adaptation, a priority which goes beyond the energy sector and encompasses all development efforts and activities towards “climate proofing” and resilience building.

While energy access and efficiency is the first line of attack with regard to climate change issues, conservation of natural resources is the first line of defense. Forestry and agriculture may not directly contribute to anthropogenic greenhouse gas (GHG) emissions but are also excellent options for mitigating net GHG emissions including bio-energy and biomass products. Improved land management in Africa will have a positive impact on GHG mitigation.

Energy Access and GHG Reduction through Mitigation

In the context of the development of its contributions towards the Clean Energy and Development Investment Framework (CEDIF)¹⁵ as its own efforts to mainstream sustainable energy development and climate change in its operations, the Bank will engage in an in-depth analysis of the role of energy in the various focal areas of the Bank, and seek to analyze the barriers and constraints to increasing access to sustainable energy so as to find the right investment approach.

The Bank is revising its 1994 Energy Policy. The objectives of the new Energy Policy are expected to include mainstreaming sustainable energy and climate change dimensions into policies, programs, and projects through development and applications of appropriate and relevant policies, guidelines etc.; the setting of minimum targets (in dollars, volume or number of projects) on lending programs and grant assistance in terms of climate change and sustainable energy targets, and the systematic and sustained information and research on climate change issues to direct country strategies, policies and operations¹⁶.

Without increased investment to the energy sector, the current situation of lack of access to modern forms of energy for a large share of the African population will persist. The Bank would increase its financing to this sector and use its strategic positioning in the development

¹⁵ The Clean Energy and Development Investment Framework is being developed by the World Bank and the Regional Development Banks as a response to the request by the G8 Countries in the “Gleneagles Communiqué” and looks into the development of strategies and an action plan towards increased attention for and investment in expanded energy access and clean energy for development and adaptation to Climate Change.

¹⁶ With specific respect to the Bank’s role in the preparation of the Clean Energy and Development Investment Framework (CEDIF)¹⁶, the Bank has been an active partner agency in its development since the start. The CEDIF Task Force within the Bank has presented the draft Framework to the ADB Board in an informal Board seminar end of April 2006 and received positive feedback from the Board members. Currently the Task Force is working, on a Bank CEDIF Plan of Action that will be presented to the Board in 2007 (2nd quarter) detailing the Bank’s contribution and commitments to the Framework. Adaptation is the third pillar of the Framework and is considered particularly crucial in the African and international context. The emphasis placed by the international community on adaptation - and specifically on adaptation in Africa - was recently confirmed at the UNFCCC COP meeting in Nairobi in October-November 2006. Expectations are high that the Bank will play an increasing role in the international adaptation agenda.

of the continent to leverage additional grant financing to reach the poor who often cannot afford paying cost recovery tariffs.

Africa contributes only about 5% to global carbon emissions and hence the potential of attracting carbon finance in the continent is still low compared to other continents. However, the Bank can play a leading role in assisting its RMCs take advantage of the opportunities for carbon trading opened by the Kyoto mechanisms. Engagement in carbon trading requires associated human and institutional capacities that the Bank can assist in building. Similarly, the Bank as one of the institutions having direct access to the Global Environment Facility (GEF) can play a crucial role in assisting its RMCs to access grant financing for energy efficiency, renewable energy and adaptation programs.

Climate Risk Management and Adaptation

While a substantial amount of financial and other resources for development has each year been diverted to post -disaster relief, reconstruction and rehabilitation assistance; a consensus is emerging that much more needs to be done on the preventive side. It has become clear that precautionary and effective action is urgently necessary. To this end the most promising approach, currently discussed in various international fora, is to integrate current activities promoting disaster risk reduction with ongoing and planned climate adaptation programs.

The key challenge is to mainstream disaster and climate risk management into development planning and investments. At the same time, given the inadequate support to African countries to cope with climate and disaster risks, there is also an urgent need to mobilize additional resources to assist them in their related planning efforts and implementation of programs on the ground.

The Bank has provided emergency relief and reconstruction assistance to its RMCs since early seventies. Short term relief support has been provided mainly in the form of grant resources from the SRF¹⁷ with programs mainly addressing drought and food emergencies and usually implemented through appropriate relief organizations operating in the field (WFP, etc). Longer term emergency operations, mainly for reconstruction and rehabilitation have been financed through regular Bank loans and have covered interventions mainly to rehabilitate infrastructure and public utilities (power plants, roads, bridges, irrigation systems, etc.) damaged by natural disasters such as storms, cyclones and floods.

More recently, starting in 2003, the Bank has been collaborating with the African office of the UN International Strategy for Risk Reduction (UN/ISDR Africa) and the African Union / NEPAD to develop a strategy and an action plan to promote the integration of disaster risk reduction in development planning and assistance operations in Africa.

In addition, and in line with the above increasing efforts, the Bank has very recently prepared an adaptation proposal for GEF (LDCF) financing which has been submitted (December 2006) to GEF for project preparation financing in the amount of US\$350,000. The proposal for Malawi *Climate Adaptation for Rural Livelihoods and Agriculture*

¹⁷ The 1998 Emergency Assistance Policy Guidelines states clearly that emergency relief assistance is to be grant funded mainly through the SRF and should not exceed US \$ 500,000 for any operation in any given RMC.

(CARLA) is associated to the *Malawi: Smallholders Crop Production and Marketing Project* approved by the Bank in August 2006.

In line with the strategy of the Bank to increase access to GEF funding, the Bank has submitted a number of proposals to TerrAfrica (TA) Strategic Investment Program (SIP) (a platform for Sustainable Land Management in Africa to which the Bank is a founding member with the World Bank and other partners) for a US\$10 million funding.

The Bank is also active through the African Water Facility and will assess the economic, social and economic impacts of climate change on the major river basins of Africa and thus contribute to the global knowledge of the issue. In January 2007, the Bank, in partnership with AU, ECA, the Global Climate Observing System, and International Research Institute for Climate and Society (IRI) (part of the Earth Institute of Columbia University), published and launched the inaugural issue of a new series, *Climate and Society*, which is managed by IRI. These partners believe that learning to better manage climate variability today will increase the capacity to adapt to future climate change.

Furthermore, the Bank has recently been mandated together with the African Union Commission and the UN Economic Commission for Africa, to develop and implement the Plan on Climate Change and Development in Africa (ClimDev-Africa) including activities relating to policy design; climate risk management; climate services; and climate data inventory as well as mobilizing funds for climate change strategies.

4. Conclusion:

4.1 The African Governments need to respond decisively to the impacts of climate change by diversifying supply, building a low-carbon energy mix, and opening up the market to private sector innovation and investment. Governments need to ensure a transparent and level playing field to create a market for low-carbon energy. This is crucial to ensure the long-term security of energy system, and continued growth of overall economy in a world affected by climate change. The Bank's future action in climate change will focus on promoting a broader shift towards low-carbon economies by promoting energy efficiency and renewable energy; supporting the dissemination of carbon reduction technologies, namely improved and modern biomass technologies; small hydropower; and solar and wind; and widening access to cleaner second and third generation fossil fuels and supporting wider use of efficient and clean technologies to avoid high carbon technology lock-in.

4.2 As the impacts of climate change are already being felt in Africa and will continue so for long time in future, it is equally vital for the African Governments to build in resiliency in their development in infrastructure, agriculture, health and education sectors, to be able adapt and combat climate change impacts. The Bank will seek ways of collaborating with Asia, through partnerships, to assist RMCs with climate resilience building by developing and mainstreaming climate risk assessment and climate information tools at macro and micro levels to influence development plans, policies and project designs. The following are guiding questions for discussions at the seminar:

- What are the issues, challenges and opportunities related to promoting low-carbon development? How should low carbon development be financed, mainstreamed in the development assistance and the Asian-Africa cooperation, including technology transfer and carbon trading?

- What are the issues, challenges and opportunities related to climate adaptation? How could the climate risk management be supported, financed and be mainstreaming in development assistance? What are the specific opportunities emerging from the Asia-Africa partnership in this regard?
- What should be the role of the Governments, Financial Institutions, Donors and Private Sector?
- Bridging the financial gap with existing and/or new financial instruments: What are the specific challenges for African countries and what new instruments are required?

Executive Summary

SEMINAR FOR GOVERNORS

THE ENHANCED PERFORMANCE BASED ALLOCATION (PBA) AND THE DEBT SUSTAINABILITY FRAMEWORK/ DEBT SUSTAINABILITY ANALYSIS (DSF/DSA)

Concept Paper

Prepared by: *The Resource Mobilization and Partnerships Unit (ORRU), African Development (AfDB)*

Date: *15 May 2007*

Venue: *Auditorium
Shanghai International Convention Center, Oriental Riverside Hotel*

Time: *5:00 pm to 6:00 pm*

1. The enhanced performance-based allocation system and the associated debt sustainability framework/debt sustainability analysis (PBA/DSF/DSA), presents a transparent mechanism for allocating concessional ADF resources to eligible borrowers based on performance, need, and population.
2. The PBA/DSF/DSA system is a two step process. The first is the determination of country allocations using the enhanced PBA framework, and the second, the determination of the financing terms using the DSF/DSA system.
3. The country allocations are determined using an enhanced PBA formula. The formula is a geometric, multiplicative function of three main variables: (i) per capita income, (GNI/P), as an indication of the country's need; (ii) an adjusted country performance assessment score (CPA*) that measures the country's performance; and (iii) the level of population in the country (P). A Governance Factor (GF) which gives an indication of the country's performance in the area of governance, and a Post Conflict Enhancement Factor (PCEF) to support the efforts of post-conflict countries, are used to convert the basic CPA to the adjusted CPA. The basic CPA is a weighted average of Country's Policy and Institutional Assessment (CPIA) score which assesses the country's social, economic, political and institutional environment; and the country's Portfolio Performance Rating (CPPR) which measures the performance of the Bank's portfolio in the country.
4. After the determination of the country's allocation using the PBA system, the loan/grant financing terms are determined by the degree of debt distress associated with the country, using the DSF/DSA. The DSF/DSA classification is illustrated by the traffic light system with "green" signifying low risk of debt distress corresponding to 100 percent loan; "yellow" signifying moderate risk of debt distress corresponding to 50/50 loan/grant combination; and "red" signifying high risk of debt distress corresponding to 100 percent grant.
5. Based on the 2005 DSF country risk rankings, 14 countries were classified as loans only, 21 as grants only, and 5 as a combination of loans and grants. In the 2006 DSF/DSA country risk rankings, 16 countries were classified as loans only, 20 as grants only, and 4 as a combination of loans and grants.
6. A number of issues and challenges related to the application of the PBA system and the DSF/DSA are being addressed by the MDBs, ADF Deputies, and the Boards of Directors and Governors to improve the efficiency in the use of ADF resources. These include (i) complexity of the PBA formula; (ii) predictability of annual country allocations; (iii) subjectivity of performance ratings (iv) double counting of the Governance Factor; (v) the weight of the population factor; (vi) the Country Portfolio Performance Ratings process; (vii) the Post Conflict Enhancement Factor; (viii) front and back loading mechanism; (ix) eligibility criteria for re-allocation of ADF-X resources; (x) the Free Rider Problem; and (xi) relative weights of key variables in the enhanced PBA formula.

1. Introduction

1.1 The enhanced performance-based allocation (PBA) system and the debt sustainability framework currently being used to allocate ADF-X resources, is an adaptation of IDA's PBA framework. It was introduced in 1999 during the ADF-VIII (1999-2001) period and has evolved with a number of modifications and refinements into the enhanced PBA.

1.2 The aim of the PBA system is to present a transparent mechanism for allocating concessional ADF resources to eligible borrowers based on performance and need, with a higher premium on performance than on need.

1.3 This concept note outlines the key features of the nexus - Performance Based Allocation/ Debt Sustainability Framework and related forward-looking Debt Sustainability Analysis (PBA/DSF/DSA) – and identifies the emerging issues and challenges relating to the implementation of the PBA. The purpose of the concept note is to provide the background information for a seminar on PBA/DSF/DSA for Governors and to set the tone for addressing the issues and challenges related to the enhanced PBA system.

1.4 The concept note has four main sections. Following the Introduction, Section II presents the main elements of the enhanced PBA/DSF/DSA framework. Section III discusses the application of the enhanced PBA/DSF/DSA framework to the 2006 country allocations. Section IV reviews the key issues and challenges in the implementation of the PBA framework, while pertinent questions relating to the issues and challenges being addressed by MDBs, ADF Deputies, and the Boards of Directors and Governors, are contained for Section V.

2. The Enhanced Performance Based Allocation Framework for ADF-X

2.1 The PBA/DSF/DSA system is a two step process. The first is the allocation of the resources using the enhanced PBA framework, and the second is the determination of the financing terms using the DSF/DSA system. The enhanced PBA formula used in allocating ADF-X resources to RMCs is a geometric, multiplicative function of three main variables: (i) an indication of the country's need given by the per capita income, (GNI/P); (ii) a measure of the country's performance using the adjusted country performance assessment score (CPA*); and (iii) the level of population in the country (P)¹⁸.

¹⁸ The allocation formula is given thus:

$$A_i = (\text{GNI/P})_i^{-\lambda} (\text{CPA}^*)_i^{\theta} (\text{P})_i \quad (1)$$

where: $(\text{CPA}^*)_i = (\text{CPA})_i (\text{GF})_i (\text{PCEF})_i \quad (2)$

$$(\text{CPA})_i = \alpha \text{CPIA}_i + \beta \text{CPPR}_i; (\alpha + \beta) = 1.0 \quad (3)$$

- A_i is the allocation share for country i ;
- GNI/P is gross national income per capita, a proxy for poverty level;
- P is the level of population
- λ is a fixed exponential assigned to the poverty variable ($\lambda = 0.125$); and
- θ is the performance exponential, fixed at $\theta = 2$
- CPA^* is the adjusted Country Performance Assessment
- CPIA is the Country Policy and Institutional Assessment
- CPPR is the Country Portfolio Performance Rating
- GF is the Governance Factor
- PCEF is the Post Conflict Enhancement Factor
- $\alpha = 0.70$; $\beta = 0.3$; are fixed parameters

2.2 A Governance Factor (GF) which gives an indication of the country's performance in the area of governance, and a Post Conflict Enhancement Factor (PCEF) to support the efforts of post-conflict countries, are used to convert an the basic CPA to the adjusted CPA. The basic CPA is a weighted average of Country's Policy and Institutional Assessment (CPIA) score which assesses the country's social, economic, political and institutional environment; and the country Portfolio Performance Rating (CPPR) which measures the performance of the Bank's portfolio in the country.

2.3 Sixteen (16) criteria in 4 clusters are used in determining the CPIA for ADF-X, as shown in Annex I. The thrust of the design is to assess the quality of a country's present policy and institutional framework in ensuring the efficient utilization of scarce development resources in the pursuit of sustainable and poverty reduction development programs in the RMCs. Countries are rated on a scale of 1 – 6 with 1 representing "Highly Unsatisfactory" and 6 representing "Highly Satisfactory".

2.4 The determination of the overall portfolio performance entails an assessment of the project performance and results using 14 implementation progress indicators, 4 development objectives indicators, and a measure of projects at risk, as described in Annex II. The assessments are determined by field staff and desk-based supervisors, and are subject to review by inter-departmental committees and managers. The portfolio performance rating is on a scale of 1 – 6 with 1 representing portfolios with the highest risk and 6 representing portfolios with lowest risk.

2.5 The enhanced PBA formula differentiates between good and poor governance by the inclusion of a Governance Factor (GF) in the formula. The GF is measured by the country's average rating for six governance criteria made up of the five criteria in the Governance and Public Sector Performance cluster in the CPIA and the procurement element in the CPPR.

2.6 Besides the governance factor, a post-conflict enhancement factor (PCEF) is built into the formula to increase the allocation of resources to post-conflict countries in support of their recovery and in recognition of the period of exceptional need in which they find themselves. However, beneficiaries are eligible for a limited period of up to 6 years, after which they are expected to graduate into normal regional member countries. Angola, Burundi, Congo DRC, Congo Republic, Eritrea, and Liberia¹⁹ are the countries currently classified as beneficiaries of the PCEF.

2.7 A questionnaire for assessing the progress being made by the country to emerge out of conflict is used in determining the PCEF. As shown in Annex III, the questionnaire is used to determine the rating for 12 indicators in four broad areas, namely, security and reconciliation;

The exponent for CPA, θ , is fixed at 2.0, relatively higher than the exponent of the measure of poverty, λ , which is fixed at 0.125. This is in support of the policy of steering resources towards high performance. The negative exponent of the poverty level ensures that relatively more resources are allocated to poorer countries. The values of the fixed parameter for the model are very close or identical to that of the World Bank (IDA). For example in the IDA's PBA formula, $\lambda=0.125$, $\theta = 2$, $\alpha = 0.80$, $\beta = 0.20$, the exponent of the Governance Factor is 1.5 compared to 1.0 for AfDB, and the exponent of the level of Population is 1 as is the case for AfDB.

¹⁹ In September 2006 when the revised 2006 country allocations were determined, the following 9 PCCs were PCEF beneficiaries: Angola, Central African Republic (CAR), Congo DRC, Congo Republic, Eritrea, Guinea Bissau, Liberia, Sierra Leone, and Sudan. As of mid-October 2006 Sierra Leone has graduated from post conflict status, and the following 3 RMCs are now excluded: CAR, Guinea Bissau, and Sudan.

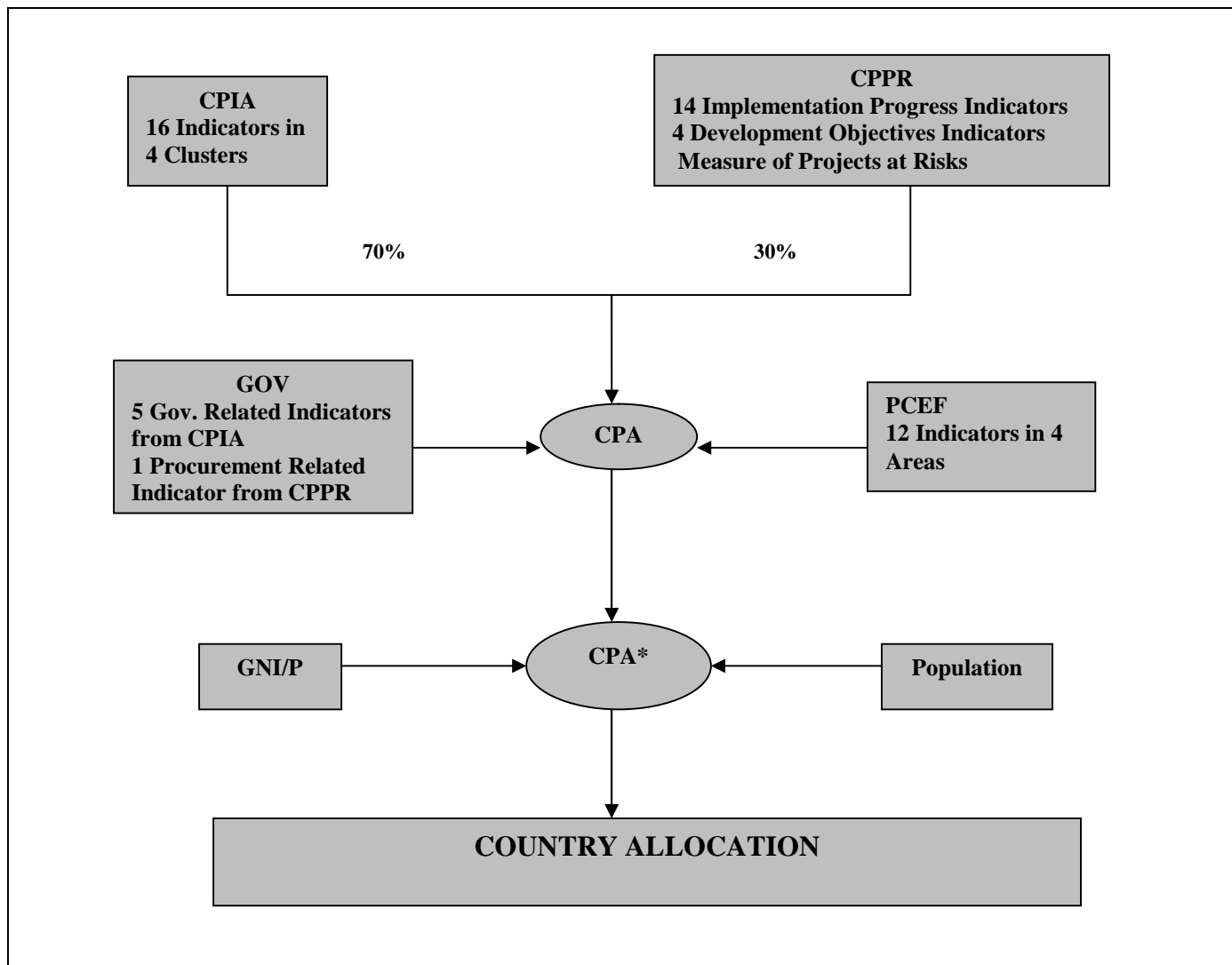
economic recovery; social inclusion and sector development; and public sector management and institutions. Each indicator is evaluated on a scale of 1 to 10 and the average rating determined. The PCEF is calculated using the formula:

$$\text{PCEF} = \{1 + ((\text{No. of indicators} / \text{Total number of ratings}) \times \text{the average rating})\}$$

$$\text{Specifically, PCEF} = \{1 + ((12/120) \times \text{the average rating})\}$$

2.8 For countries that are not in post-conflict situation, the PCEF is 1, and for PCEF countries, the value is greater than 1. As shown in Annex IV the average PCEF for 2006 was 1.30. Over the 6-year period that a country benefits from the PCEF, a conscious effort is made to progressively reduce the PCEF rating. Thus, the overall rating assigned to particular PCCs would show a declining trend until the country graduates out of the PCC status to become regular RMCs. Chart 1 provides a schematic diagram for the determination of country allocation using the PBA system.

Chart 1: **Determination of Country Allocation using the PBA System**



2.9 The enhanced PBA system also provides all countries with a basic minimum allocation of UA 5 million. This results in an upward bias in the per capita allocations to small countries.

The Debt Sustainability Framework (DSF)

2.10 After the determination of the country’s allocation using the PBA system, the loan/grant financing terms are determined by the degree of debt distress associated with the country, using the DSF. There are two approaches in the DSF; the Static Approach and the Dynamic Approach.

The Static Approach

2.11 The Static Approach is based on two pillars: (i) the indicative country specific external debt burden thresholds which are associated with the country’s institutional strength and quality of policies; and (ii) the country’s actual debt burden indicators (i.e. NPV of debt/GDP ratio, NPV of debt/exports ratio and debt service/ exports ratio).

2.12 On the basis of the debt burden indicators and the CPIA classification, countries are categorized as weak, medium or strong in terms of their institutional strengths and quality of policies to withstand debt distress. Indicative external debt burden thresholds are determined for each category as shown in Table 1, and a comparison made between the indicative thresholds and the actual debt burden indicators.

2.13 Table 1 below indicates that countries with different levels of policy performance (weak, medium, and strong policies) can accommodate distinct levels of debt burden. A country will be classified under high risk of debt distress if its debt burden indicator exceeds the relevant threshold by more than 10 percent; in such a case, the country’s allocation is provided in 100 percent grants. On the other hand, a country will be classified under low risk of debt distress if its debt burden indicator falls below the relevant threshold by more than 10 percent; in this case the country qualifies for 100 percent loans only. In the same vein, a country is assessed to have a moderate risk of debt distress if its debt burden indicator is within $\pm 10\%$ of the relevant threshold; in this final case, the allocation is split and provided in 50/50 loan grant proportions. This procedure is characterized as the Pure Volume Approach.

**Table 1
Indicative Debt -Dependent Policies and Debt Service Thresholds**

Debt Burden Indicators	Assessment of Institutional Strength and Quality of Policies		
	Weak CPIA \leq 3.25	Medium 3.25 < CPIA < 3.75	Strong CPIA \geq 3.75
NPV of Debt to GDP Ratio	30	40	50
NPV of Debt to Exports Ratio	100	150	200
Debt Service to Exports Ratio	15	20	25

2.14 During the ADF-X replenishment consultations, the Deputies adopted a Modified Volume Approach which applies a 20 percent volume discount, sub-divided into two components. The first component is an incentives related portion (8 percent) to help maintain the strength of the ADF incentive structure as reflected in the PBA system; and the second

component is a charges-related portion (12 percent) on ADF grants. The charges-related portion of the volume discount (i.e. the 12 percent), does not apply to post conflict countries.

The Dynamic Approach

2.15 Deputies also decided at the ADF-X replenishment consultations, that the static approach should give way to a ranking based on insights generated by forward-looking debt sustainability analyses (FL-DSF). The FL-DSF incorporates country specific features, including integration of fiscal and macroeconomic indicators, impact of exogenous shocks, and a deeper analysis of the evolution and composition of the existing debt stock. Beginning with 2006, the results from the joint IMF/IDA forward looking debt sustainability analysis exercise was used to determine the loan/grant financing terms for the 38 ADF-only countries.

3. Application of the PBA and DSF for 2005 and 2006

3.1 The DSF classification is illustrated with the traffic light system with “green” signifying low risk of debt distress corresponding to 100 percent loan; “yellow” signifying moderate risk of debt distress corresponding to 50/50 loan/grant combination; and “red” signifying high risk of debt distress corresponding to 100 percent grant. Based on the 2005 DSF country risk rankings 14 countries were classified as loans only, 21 were classified as grants only, and 5 classified as a combination of loans and grants. See Table 2 below.

Table 2
DSF Classification for 2005

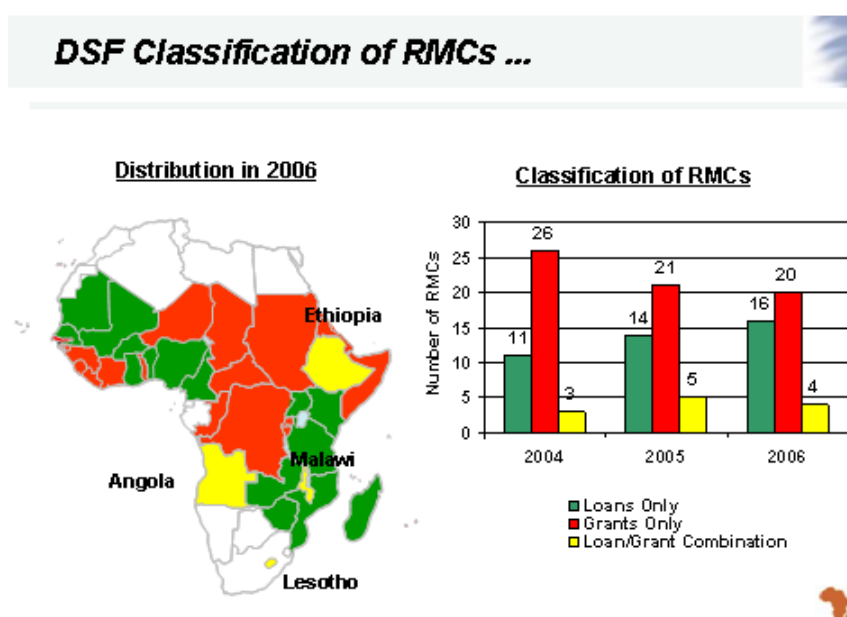
Classification	Countries
Loans Only (14)	Burkina Faso, Cape Verde, Djibouti, Ghana, Kenya, Madagascar, Mali, Mozambique, Mauritania, Niger, Nigeria, Senegal, Tanzania and Zimbabwe
Combination of Loans & Grants (5)	Benin, Ethiopia, Lesotho Uganda and Zambia
Grants Only (21)	Angola, Burundi, Cameroon, Central African Republic, Chad, Democratic Republic of Congo, Republic of Congo, Comoros, Cote D’Ivoire, Eritrea, Gambia, Guinea, Guinea Bissau, Liberia, Malawi, Rwanda, Sao Tome & Principe, Sierra Leone, Somalia, Sudan and Togo.

3.2 Based on the 2006 DSF country risk rankings, 16 countries were classified as loans only, 20 as grants only, and 4 as a combination of loans and grants. See Table 3 below. Figure 1 shows the evolution of the classification of RMCs based on the DSF country risk ranking from 2004 – 2006.

Table 3
DSF Classification for 2006

Classification	Countries
Loans Only (16)	Benin, Burkina Faso, Cameroon, Cape Verde, Ghana, Kenya, Madagascar, Mali, Mauritania, Mozambique, Nigeria*, Senegal, Tanzania, Uganda, Zambia and Zimbabwe*
Combination of Loans and Grants (4)	Angola, Ethiopia, Lesotho and Malawi
Grants Only (20)	Burundi, CAR, Chad, Comoros, Congo D.R., Congo Rep., Cote d'Ivoire, Djibouti, Eritrea, Gambia, Guinea, Guinea-Bissau, Niger, Liberia, Rwanda, Sao Tome & Principe, Sierra Leone, Somalia, Sudan and Togo

Figure 1: DSF Classification 2004-2006



4. Issues and Challenges of the PBA System

4.1 There are a number of issues and challenges related to the application of the PBA system and the DSF. These include (i) complexity of the PBA formula; (ii) predictability of annual country allocations; (iii) subjectivity of performance ratings (iv) double counting of the Governance Factor; (v) the weight of the population factor; (vi) the Country Portfolio Performance Ratings process; (vii) the Post Conflict Enhancement Factor; (viii) front and back loading mechanism; (ix) eligibility criteria for re-allocation of ADF-X resources; (x) the Free Rider Problem (xi) relative weights of key variables in the enhanced PBA formula. These issues and challenges are briefly discussed below.

Complexity of the PBA Formula

4.2 The PBA has evolved over time taking into account the priority and insights of donors. Even though the changes have increased the efficiency in the use of ADF resources, they have made the formula more complex over time, and difficult to analyze the impact of each of the determinants on the allocations. The annual MDBs technical meetings in Manila (January 2005), Tunis (March 2006) and Washington, DC (January 2007) addressed this issue, and proposals for simplification of the formula are being examined by ADF/IDA Deputies during the ongoing IDA15 and ADF-XI replenishment consultations.

Predictability of Annual Country Allocations

4.3 ADF-eligible countries are faced with the problem of predictability of annual allocations from two angles. First, there is the problem of the predictability of annual resource allocation due to annual variations in the input variables in the PBA formula: CPIA, CPPR, GNI per capita and the Governance Factor (GF). This is compounded by the new policy on annual allocations, which specifies firm allocations only for the first year, but indicative allocations for the second and third years of the ADF cycle. Second, there is the problem of predictability of loan/grant eligibility on an annual basis. Application of the DSF could lead to a reclassification of some RMCs. As a result, some RMCs may receive grants in one period, loans in another period, and loan/grant combinations in some other periods²⁰. A country classified to receive 100 percent loans, and engaged in negotiations on projects on the basis of grant segments, may be faced with a situation where the financing conditions would change. These problems with predictability make it difficult to plan ADF-funded interventions at the country level.

Subjectivity of Performance Ratings

4.4 There is some element of subjectivity in the determination of the CPIA and CPPR assessments. The assessments are carried out by the country teams. Through the peer review process at the inter-departmental level and through harmonization with World Bank (IDA) ratings, the subjectivity element is significantly reduced.

Double Counting of Governance Factor (GF)

4.5 In the determination of the GF, six criteria in the Governance and Public Sector Performance cluster in the CPIA, and the procurement element in the CPPR are used, resulting in a double counting of the GF. This is compounded by the fact that the GF gets squared in the formula. Thus, any small change in the rating of the governance and public sector cluster in the CPIA magnifies into a large change in the adjusted CPA, and the corresponding country allocation. This is vividly illustrated in the implications on the 2006 country allocation envelopes of Burkina Faso, Chad and Ghana²¹.

²⁰ The following are some examples. Cameroon which was classified to receive 100 percent grants during the 2005 PBA process, was re-classified to receive 100 percent loans during the 2006 PBA process. Benin, Uganda, and Zambia which were classified to receive a combination of loans and grants in various proportions during the 2005 PBA process, were re-classified to receive 100 percent loans under the 2006 PBA process. Also, Djibouti and Niger which were classified to receive 100 percent loans under the 2005 PBA process, were re-classified to receive 100 percent grants under the 2006 PBA process.

²¹ For the 2006 PBA exercise, the results of the 2005 CPIA and GF ratings were used for all RMCs. For the case of Ghana, the governance factor declined to 1.0, below its 2004 GF rating of 1.07 (a 6.7 percent

The weight of the Population Factor

4.6 The enhanced PBA system is designed to reward countries with higher performance and encourage low performing countries to improve their performance. However, the reward is on per-capita basis, which implies that the higher the adjusted CPA, the higher is the per capita allocation. The population factor in the PBA formula converts the per-capita allocation to total country allocation in absolute terms. This allows for the possibility of relatively low performing countries with relatively higher population being allocated larger shares of ADF concessional resources, in absolute terms, vis-à-vis the high performing countries.

4.7 For example, Cape Verde, one of the top performing countries (adjusted CPA of 4.22), with a population of 0.5 million, receives a per-capita allocation of UA 20.73, the second highest among all RMCs, but a total allocation of UA 10.26 million, compared with Togo, a low performing country (adjusted CPA of 1.51), which receives a lower per capita allocation of UA 1.72 as expected, but with a population size about 12 times that of Cape Verde, gets almost the same total allocation of UA 10.32 million.

The Country Portfolio Performance Ratings Process

4.8 Experience of MDBs since 1999 show that volatility in the CPA is driven to a large extent by the way the portfolio ratings are computed. There are two main problems related to these ratings. The first relates to the realism of these ratings, affected by the inherent under-reporting of risks by staff, and the second to their volatility, which in turn increases volatility of country allocations, particularly in IDA, AsDF and AfDF. Further analysis shows that sharp swings in portfolio ratings come from two main sources: (i) the conversion scale, mainly in the case of IDA as compared to that of ADF; and (ii) the use of information from one point in time at the end of each calendar year. These issues were addressed at the latest MDBs PBA technical meeting in Washington DC (January 2007).

Post Conflict Enhancement Factor and Other Alternative Measures

4.9 The PBA formula has a built-in post conflict enhancement factor (PCEF). Therefore, additional allocations to PCCs are determined within the framework of the PBA exercise thus limiting the resources available for allocation to countries that are not in conflict. In contrast, additional resources from IDA to the PCCs are determined from a pool of extra resources outside of the PBA system.

Annual Allocations and the Front and Back Loading Mechanism

4.10 In line with the new policy on annual ADF allocations approved by the Boards of Directors on 29 September 2006²², the ADF-X resource envelope is allocated over a 3-year lending period, with *firm* amounts for just the first year and *indicative* amounts for the second and third years. A country could experience a shortfall in its allocation envelope in the second

decrease). The net effect is a 2006 PBA envelope of UA 160.32 million for Ghana, compared with its 2005 PBA envelope of UA 191.22 million, a substantial 16.2 percent decrease.

²² See *Annotated Format for Bank Group Results-based Country Strategy Papers (RB-CSPs)*, dated 19 September 2006, ref.: ADF/BD/WP/2004/179/Rev.4/Approval, Section 4.6, pp. 17-18. See also *Enhanced Performance-based Allocation Framework for ADF-X*, ref.: ADF/BD/WP/2005/93/Rev.1, dated 5 August 2006, paras 3.7.3 – 3.7.6.

year of the 3-year ADF cycle. Under such a circumstance the country may not have to stop ongoing negotiations on projects, cancel, or scale down such projects or programs, because of the temporary shortfall. By applying the front and back loading mechanism the country can smooth out the programming and implementation of its projects and programs.²³.

Eligibility Criteria for Reallocation of ADF-X Resources

4.11 Under the Enhanced PBA Framework for ADF-X, idle resources from non-performing countries are reallocated to performing countries during the third year of the ADF cycle. However, the performing countries would have to satisfy a set of eligibility criteria including a requirement that they must have an adjusted CPA ≥ 3.0 and a CPIA ≥ 3.25 . The other criteria include the following: country must demonstrate high absorptive capacity; country's project must conform with ADF strategic priorities and ADF-X lending and financing priorities and guidelines; and country must not have accumulated any arrears or be under Bank Group sanctions.

The Free Rider Issue and Implications for the DSF and the MDRI

4.12 Grant recipients and MDRI-eligible countries with sharply reduced debt burdens are potential targets for new borrowing from commercial and other non-concessional sources. The "free riding" issue refers to situations in which non-concessional lenders take advantage of the reduced debt burden – which they did not contribute to - by providing non-concessional lending to ADF and IDA eligible countries. Through collective action by all MDBs, and IFIs alike, a system of incentives and penalties can be adopted to discourage this problem.

2. Pertinent Questions relating to the Issues Raised in the Implementation of the PBA System

5.1 The issues and challenges of the PBA system examined under Section IV of this paper are complex and require careful review and guidance by ADF Deputies and the Boards of Directors and Governors. The following are some of the key issues for consideration.

- i. What are the main elements of a simplified PBA formula that achieves the underlying objectives of the enhanced PBA system?
- ii. How would the volatility and the problem of predictability be minimized and/or eliminated?
- iii. How can the double counting of governance in the PBA system be removed?
- iv. Should the weight of the population factor be reduced and to what level?

²³ The policy states that during the first and second years of the lending cycle, countries may front load up to 50 percent of the next year's allocation or back load up to 100 percent of the previous year's allocation that was not committed during that year. For countries with minimum allocation (i.e., allocation envelopes less than UA 10 million) the country is allowed to have firm allocation of 50 percent of the allocation envelope during the first year, and can front load up to 100 percent of the outer year's allocation. See ref.: ADF/BD/WP/2005/93/Rev.1, para 3.7.3, third bullet.

- v. How could the volatility in the CPPR process be addressed? Cleaning up of the portfolio, improve supervision of projects, applying a three year moving average of the rating etc.
- vi. Should the PCEF be eliminated from the PBA formula and a pool of resources set aside from the ADF replenishment resources to cater for the needs of the PCCs?
- vii. How can the free rider issue be reconciled with the need for additional development resources needed to achieve the MDGs in ADF-only countries?

CPIA Criteria under ADF-X

A. Economic Management

1. Macroeconomic Management
2. Fiscal Policy
3. Debt Policy

B. Structural Policies

4. Policies and Institutions for Economic Cooperation, Regional Integration & Trade
3. Financial Sector
4. Business Regulatory Environment

C. Policies for Social Inclusion/Equity

7. Gender Equality
8. Equity of Public Resource Use
9. Building Human Resources
10. Social Protection and Labor
11. Environmental Policies and Regulations

D. Public Sector Management and Institutions

12. Property Rights and Rule-based Governance
13. Quality of Budgetary and Financial Management
14. Efficiency of Revenue Mobilization
15. Quality of Public Administration
16. Transparency, Accountability, and Corruption in the Public Sector

Country Portfolio Performance Rating (CPPR) Methodology

1. The assessment of the overall portfolio performance begins with an assessment of the project performance and results in a series of ratings that cover various aspects of project implementation. The assessments are determined by staff based on field or desk-based supervisions, but are subject to review by committees and managers. Two separate scores for each individual project are calculated from the ratings, as described below.

2. The first score, Implementation Progress (IP), attempts to measure relative satisfaction achieved in project execution at a given point in time. This score is based on the average of 14 separately rated indicators for elements such as project management, procurement and fulfillment of loan conditions. The second score measures the likelihood that the project will achieve its development objectives (DO), and is based on the average of 4 indicators, such as the contribution to institutional capacity and the longer-term impact of the project on the beneficiary group. Each of the 18 indicators is rated on a four point scale (0,1,2,and 3)

3. The 14 IP indicators and 4 DO indicators are averaged separately. An average score of less than 1.5 constitutes a problematic rating. This threshold is consistently applied to all ratings. For a project to be considered problematic, it must possess either an IP *or* a DO score with a value less than 1.5. Thus, it is not necessary for the project to have both an IP and DO less than 1.5 to be considered problematic.

Determination of Projects-at-Risk (PAR)

4. The next step in the assessment is to determine which projects have the *potential* of becoming problematic. This classification signifies that although the project is performing satisfactorily in terms of both IP and DO, there are other indicators, which suggest that the project *may* become problematic in the future. For a project to be classified as *potentially* problematic, it must meet at least 2 of the following criteria:

- Elapsed time between approval and effectiveness is greater than 12 months. This applies to all operations: projects, structural adjustment loans, and technical assistance activities.
- Conditions precedent (item A1 of the project rating form) is rated at less than 1.5.
- Procurement of goods and services (B.2) is rated at less than 1.5.
- Project management (D.4) is rated at less than 1.5.
- Counterpart funds (C.2) is rated at less than 1.5.
- Country has a record of high rate of project failure (PPAR/PCR failure rate of 50% in a weak country in terms of macro-economic criteria).
- IP *or* DO ratings indicate unsatisfactory ratings two years in a row.

5. The definition of a *potentially* problematic project has been revised in order to apply new, more stringent criteria. The changes include adding the following new criteria to the definition:

- ◆ **Refinement of the definition of Projects at Risk:** Additional indicators or risk flags were included in the potentially problematic operations list:
 - less than 10 percent of the loan for a specific operation has been disbursed two years after loan effectiveness, or less than 50 percent of the loan has been disbursed 5 years after loan effectiveness;
 - projects are not completed after 8 years (5 years for TAF/Grants) from the date of approval;
 - TAF/Grant-financed capacity building operations have less than 50 percent of the resources disbursed after 3 years from approval; and,
 - a loan- or grant-funded operation is not yet declared effective 12 months after signature.

6. By combining potentially problematic projects with actual problem projects (PP), the criterion "projects-at-risk" (PAR) is obtained. The projects-at-risk indicator mitigates possible underestimation of problem projects by being based on a more comprehensive assessment of the portfolio status. In studies conducted at sister institutions, it has been found that some project officers feel the ratings of operations reflect on them personally – giving rise to a tendency to rate projects better than they actually are. Caution, however, should be applied in the interpretation of the PAR figure, since PAR includes projects that *may* become problematic as well as those which *are* problematic. **Note that PAR does *not* predict a negative outcome, but instead draws attention to those projects where additional focus may be needed.**

7. The final step involves converting the number of PARs into percentages and assigning the CPA score. This is done by dividing the actual number of PARs by the number of rated operations for each country. Thus, a country that has ten active, rated projects of which 2 are "at-risk", would have a PAR rate of 20%, and a score of 4.0 as indicated in Box 2 below. The new six point scale, as shown below, has been applied since the beginning of 2002. As observed, through the introduction of 0.5 gradients in 2004, the new conversion scale during ADF-IX "rewards" RMCs for smaller increments in portfolio improvement as compared to the previous scale under ADF-VIII.

8. Because of the application of these more rigorous criteria, the overall rate of projects-at-risk increased by about ten percentage points as compared to the previous rating system. The anticipated impact of this change in methodology is that the CPPR rating for several countries will be lower under the new rating system as compared to when the previous rating system was used.

Box 2 : Projects at Risk	
Conversion Table	
% Projects at Risk per Country (X)	Rating
X = 0% for 3 or more years	6.0
0 < X ≤ 5%	5.0
5 < X ≤ 15 %	4.5
15 < X ≤ 30 %	4.0
30 < X ≤ 35 %	3.5
35 < X ≤ 45 %	3.0
45 < X ≤ 65 %	2.5
X > 65%	2.0
X > 65% for 3 or more years	1.0

Annex III

POST-CONFLICT PROGRESS INDICATORS

<p>A. <u>Security and Reconciliation</u></p> <p>1. Public Security</p> <ul style="list-style-type: none"> • Effectiveness of civilian policing and efforts to reduce crime • Security for war-affected populations <hr style="border-top: 1px dashed black;"/> <p>2. Reconciliation</p> <ul style="list-style-type: none"> • Government legitimacy • Progress of mediation process • Integration of parties to the conflict <hr style="border-top: 1px dashed black;"/> <p>3. Demobilization and Disarmament</p> <ul style="list-style-type: none"> • Effectiveness of D&D program • Effectiveness of efforts to integrate ex-combatants 	<p>These indicators underscore the importance of a sustainable peace in post-conflict countries. They assess the authorities' efforts to reduce the probability of renewed conflict and to provide security to the population. They are measures of actions taken by the government to improve the environment for sustainable peace. For several of these indicators, the Fund will need to rely on information provided by UN and bilateral agencies.</p>
<p>B. <u>Economic Recovery</u></p> <p>4. Management of Inflation, External Debt; Adequacy of Budget</p> <ul style="list-style-type: none"> • Composition of budget • Progress on structural reforms and IMF program • Management of fiscal deficit and debt <hr style="border-top: 1px dashed black;"/> <p>5. Trade policy, Foreign Exchange, and Price Regimes</p> <ul style="list-style-type: none"> • Functioning of customs authorities • Efficiency of foreign exchange regimes <hr style="border-top: 1px dashed black;"/> <p>6. Management and Sustainability of the Development Program</p> <ul style="list-style-type: none"> • Soundness of reform program • Progress on implementation • Use of participatory processes 	<p>This cluster measures the extent to which policies have been implemented to spur economic recovery.</p>
<p>C. <u>Social Inclusion and Social Sector Development</u></p> <p>7. Reintegration of Displaced population</p> <ul style="list-style-type: none"> • Government efforts to assist displaced people and returnees. <hr style="border-top: 1px dashed black;"/> <p>8. Education</p> <ul style="list-style-type: none"> • Efforts to address urgent needs in particular primary education • Efforts to address disparities among individuals or groups affected by conflict <hr style="border-top: 1px dashed black;"/> <p>9. Health</p> <ul style="list-style-type: none"> • Urgent health care needs, particularly in war affected areas • Disparities among individuals or groups affected by conflict 	<p>This cluster assesses if immediate social needs are addressed and focuses on the distribution of assets, income and services among the groups affected by the conflict, and on government policies to reintegrate the displaced population and its provision of the most crucial services in education and health.</p>
<p>D. <u>Public Sector Management and Institutions</u></p> <p>10. Budget Formulation and Efficiency of Revenue Mobilization</p> <ul style="list-style-type: none"> • Budget formulation and implementation • Effectiveness of revenue collection and tax administration • Effectiveness of public auditing <hr style="border-top: 1px dashed black;"/> <p>11. Reestablishing the Administration and Rule-based Governance</p> <ul style="list-style-type: none"> • Functioning of civil administration • Payment of government salaries • Enforcement of contracts • Number of ministries <hr style="border-top: 1px dashed black;"/> <p>12. Transparency, Accountability and Corruption in the Public Sector</p> <ul style="list-style-type: none"> • Level of government accountability • Extent of corruption and government commitment to reduce 	<p>This cluster evaluates the quality of governance by focusing on the government's efforts to effectively manage the public sector, and on the state of its institutions.</p>

1. Background

THEMATIC SEMINAR

DEVELOPMENT FINANCING AND CHINA – AFRICA COOPERATION

Concept Paper

Prepared by: *People's Bank of China (PBC) and
China Development Bank (CDB)*

Date: *13 May 2007*

Venue: *Yangtze River Hall
Shanghai International Convention Center, Oriental Riverside Hotel*

Time: *2:00 pm to 4:30 pm*

1.1 The development financing, as a financial form, has been in existence for over a hundred years. Development financing institutions hold the key to meeting the social and economic development goals set by the governments not only in developing countries but also in developed ones. These institutions are there to realize the functions and missions that are irrealizable by the market and the commercial finance only. Particularly in developing countries, where development financing is needed to remedy system deficiency and help build the market mechanism.

1.2 Development financing institutions have been set up by both China and African countries to play an important role in the regional or national economic development. China and African countries are all developing countries with similar problems in their economic development. This provides broad scope and potential for their cooperation in agriculture, infrastructure, manufacturing and other fields. Subsequent to the successful conclusion of the Forum on China-Africa Cooperation last year, China-Africa relations enters a new era. Therefore, China is willing to strengthen dialogues with African countries on how to take advantages of development financing to promote mutually beneficial economic cooperation between China and African countries for win-win results.

Topics of this financial forum:

1.3 The theme of the forum is to push forward the China-Africa economic cooperation through development financing. There are six sub-topics:

- Opportunities and challenges for the development of African financial institutions;
- Role of development financing institutions in the economic development of Africa;
- Mode and prospects of China-Africa financial cooperation;
- Role of development financing institutions in the China-Africa economic cooperation;
- Government roles and financial stability; and
- China-Africa financial cooperation and diversified financing channels.

1.4 The main objectives of the financial forum are to:

- Promote communication and understanding between development financing institutions in China and those in African countries;
- Share practical and successful experience of the development financing institutions in China and African countries;
- Seek opportunities for the cooperation among development financing institutions; and
- Discuss the mode and methods of China-Africa economic cooperation through development financing.

2. Overall situation of China-Africa Economic Development and Cooperation

2.1 With the advent of a new century, Africa has seen an overall stable political situation. Its economy is turning better and better, and attracting more and more attention from the international community. The African economy is already on a fast growing track. In the mean time, the national economy in China has maintained a fast growth, with its economic

relations with foreign countries increasingly expanding. China-Africa economic cooperation begins to boost across many fields.

2.2 China-Africa trade is found booming. In 2006, the trade between the two parties reached up to USD55.5 billion, and has kept growing by 30% for five consecutive years. The export of China to Africa is up to USD26.7 billion, up 43% year-on-year and the import from Africa is up to USD28.8 billion, up 37% year-on-year.

2.3 Meanwhile, China is increasing its investment in Africa. By the end of 2006, China has invested USD6.3 billion in Africa, covering such fields as agriculture, communications, energy, and manufacturing. In 2006, the direct investment from China to Africa reached up to USD370 million. Represented by Yahe (Guinea) Textile, Gabon Huajia Wood, Hisense Group (South Africa) TV Set, and Huawei, all Chinese corporations have achieved good revenues locally and help boost local economic and social development.

2.4 Contract labor service from China to Africa is also developing exuberantly. In 2006, Chinese corporations achieved a turnover of USD9.5 billion on contract labor service in Africa. Since 2000, Chinese corporations have built over 6000 kilometers of road, and 8 large-/middle-scale electricity stations in Africa. Imboulou Hydropower Station of Congo by CMEC, Algeria Sheradon Hotel of Pine Club by CSCEC, and the railway re-construction project by CCECC have all won recognition from local governments and counterparts for outstanding quality.

2.5 Intensive complementarities lie in China-Africa economics. Africa is a big market involving 53 countries, with a population of more than 800 million people. With the acceleration of economic reform process of African countries, Africa has demonstrated a delighted prospect of economic development, achieving an economic growth rate of around 5% in 2006. The great market potential has gradually emerged in line with the economic growth of 11 consecutive years. As for African countries, China has commodities, technologies and advanced management methods adaptable to the economic development of African countries. In addition, China's increasing investment in Africa brings necessary capital support for their development. Therefore, very bright are the prospects for China-Africa cooperation in many fields such as infrastructure, agriculture, telecommunications, energy and manufacturing.

3. Case Study: role and practices of the CDB

3.1 Founded in 1994 and under the direct jurisdiction of the State Council of China, CDB takes "strengthening China's economy and improving people's lives" as its mission. As of the end of 2006, the total assets of CDB have reached RMB2314.3 billion Yuan while its Non-performing loan ratio has remained below 2% for the latest five years, standing at 0.75% in 2006.

3.2 In the course of its relatively brief history, CDB has not only grown into China's largest development financing institution but also one of the world's largest such institutions.

3.3 CDB's excellent market performance has meant growth that has enabled it to become a potent financial power in four areas:

- CDB has invested approximately 90% of its loans in key national economic sectors, including electric power, highways, railways, oil and gas, petroleum and chemical refining, coal, post and telecommunications, farming and forestry, water conservation and flood control and public infrastructure. Priority is attached to projects in China's less-developed western regions and the old northeastern industrial base; such initiatives have enhanced national strength as well as aiding depressed local economies. These include significant loans into massive, world-class ventures such as the Three Gorges Hydroelectricity Project, the West-to-East Electricity Transmission Network, the South-to-North Water Transfer Project, the West-to-East Natural Gas Transmission Pipeline, Beijing's Capital Airport, many of Beijing 2008 Olympic Games construction projects, Shanghai's Urban Rail System, the Beijing-Kowloon Railway, the Lingao Nuclear Power Plant, and China's National Trunk Highway System (a true national high-speed modern highway network, with five key north-south and seven key east-west expressways linking all of the major population centers and regions of China, as well as eight other interlinked highways in China's western regions).
- CDB has made significant investment in social projects such as rural development, small and medium enterprise activities, technology innovation, education, housing, health care, water conservation and environmental protection. Together with disaster response and relief, these efforts have changed the lives of hundreds of millions for the better.
- CDB has devoted time, energy and significant funding to major countries and regions with which China enjoys long-term cooperative relationships, especially its neighboring countries and regions. Towards that end, CDB carries out international cooperation in the form of loan support for Chinese businesses under the national "Going Out" policy initiative, making CDB China's most important bank in that regard.
- Ancillary to the loan and investment process, CDB has restructured and modernized China's financial systems and CDB's collaborating financial institutions, guiding the orientation of project funds through commercial banks and societal investments. CDB thus takes the initiative to implement national strategy and governmental policy, even as it improves the operational efficiency of the financing that is CDB's primary business. Additionally, it participates in the transformation and reorganization of domestic small- and medium-sized financial institutions, enhancing their stability and the competitiveness of China's financial systems.

3.4 CDB has utilized its financing strength for the country's economic and social development, in that it pioneers the market building so essential to China's modernization and revitalization. China is a developing country, and its needs have led to the following effective CDB practices:

- **Breaking financial bottlenecks by means of market building.** Like other developing countries, China has gaps, defects and under-development of various financial, regional, industry and social markets. Particularly due to voids created during China's period of policy finance, CDB has been faced with no other recourse and developed markets from scratch. In such instances, CDB has taken market-based financing as both the medium and the message. Such extraordinary efforts include the requirements and methods of market building into financial operation rules, making

efforts to construct healthy, highly efficient markets and financing systems. Such unorthodox and far-reaching efforts have been required in order to meet the financing demands for economic and social development while maintaining high standards of market performance.

- **Combining the advantages of governmental organization and coordination with those financing efficiencies of CDB to become a great power in market building.** In a period of transition of economic systems, CDB recognizes that government has functional advantages in regulation and control, management, standardization, provision of institutional framework, organization and promotion, while a development-based financial institution has the advantages in collecting and allocating large sums for long-term financial projects. CDB has partnered with local governments, national departments and large enterprises in broad-based cooperative development finance ventures, giving full play to the two advantages and jointly promoting market building. In this way, CDB has been able to achieve results desired by government through the support of development financing, “win-win” for both. The net effect is improved financing efficiency with built-in risk resistance.
- **Playing a leading role in development-based finance and facilitating the development of new fields.** In China, it has been learned that simply relying on governmental departments to regulate and control without financing motivators will lead to insufficient internal impetus and weak lever action in supporting the development of new fields. In essence, government is seen as a negative driver that needs the banker, CDB, as the countervailing positive driver for effective new economic development. Through balance of the financing drivers, appropriate planning priorities and market building criteria, CDB has encouraged governmental departments and economic agents to act positively in new fields of endeavor. CDB is seen by all of China as playing an active leadership role in the settlement of a great many tedious and difficult government problems.
- **Facilitating scientific development by means of planning priority.** CDB leverages the advantages of its banking prowess, proactively carrying out cooperative planning with local governments and sectors. Through the provision of technical assistance loans and development consultancy similar to the World Bank and Asian Development Bank, CDB attaches priority to planning for local and industrial development so as to systematically enhance the development of the whole region or industry. In this process, CDB works with local governments to jointly establish market-based financing platforms while it continues to improve its capacity for financing, market operation and risk coverage, so as to form soundly operated market-based project groups.
- **Adhering to the unification between national credit and market performance.** As a development-based financial institution of government, CDB neither relies merely on sovereign credit to the disregard of market performance, nor on market performance merely through the lens of commercial finance. Instead, CDB uses national credit to improve market performance, support economic and social development, and uses market performance to consolidate national credit and upgrade public confidence, to better realize both national and public benefits. For this purpose, CDB operates in a democratic fashion that encourages public participation and supervision. By aggregating all governmental and private stakeholders into a body

that assumes project culpability and ownership, CDB effectively controls risks and ensures the highest quality of market performance.

3.5 Currently, CDB has entered into a new phase of its own development in order to play a more important role in realizing national economic goals and implementing the government's development strategies. Yes, CDB will still base its activities on the overall economic and social development of China and the reform of its financial systems, as it remains immersed in development-based finance. Of course CDB still intends to contribute to the promotion of market building and facilitate all-round social and economic progress. However, CDB will also work towards cooperation with the economic and finance ministries and institutions of other countries to strengthen information exchange and economic cooperation. CDB intends to play a bridging role in such international exchanges and facilitate mutual economic and social progress with foreign organizations much as it has with governmental and industry partners in China in the past. It seeks nothing less than win-win opportunities for the world.

4. Conclusion

4.1 Regional, sub-regional and national development financing institutions in Africa have been playing significant roles in African countries' social and economic development. Having established and trying to build up closer cooperation with these development financing institutions, CDB believes that by sharing our experience and practices we can work together to further promote and better serve China-African economic and trade cooperation and achieve mutually beneficial and win-win results.

1. Introduction

THEMATIC SEMINAR

AFRICAN/CHINESE ENTERPRISES FORUM: AFRICAN INVESTMENT, FINANCING AND RISK

Concept Paper

Prepared by: *People's Bank of China (PBC) and
China Development Bank (CDB)*

Date: *14 May 2007*

Venue: *Auditorium
Shanghai International Convention Center, Oriental Riverside Hotel*

Time: *9:00 am to 12:30 pm*

1.1 China/Africa trade and investment flows are blooming. Bilateral trade reached US\$ 40 billion in 2005 and is set to exceed US\$ 50 billion in 2006. Investments by the Chinese in Africa surpassed US\$ 6 billion in 2005 while Africans are cautiously beginning to invest in the fast growing populous country.

1.2 China's influence in Africa has changed significantly over the past decade. China's investment in Africa is predominantly due to the following:

- **Commodities** – China's growing industries demand new energy and raw material suppliers. Within the next decade China will surpass the United States as the largest global consumer of oil. China currently imports 28% of its oil and gas from sub-Saharan Africa. Sudan supplies, for example, 7% of China's total oil imports.
- **Export** – China is looking for new markets for its products. According to Chinese government reports, trade between China and Africa increased over 35% between November 2004 and 2005.

1.3 It is estimated that 674 Chinese companies were operating in Africa by June 2004. The total contracted investment of these companies was approximately US\$ 1.5 billion. In 2005 alone, Chinese construction companies won US\$ 6.3 billion worth of contracts in Africa. China has also used debt relief to assist African nations. Since 2000, China wrote off US\$ 1.2 billion in African debt followed by an additional US\$ 750 million in 2003.

1.4 How to facilitate the co-operations between African and Chinese enterprises and how to support their businesses are the major objectives of this forum. Standard Bank as a local African commercial bank, and China Export & Insurance Company as the Chinese export and investment promoter are good partners to co-host this forum and to serve the purpose of the meeting. As indicated below, the African Development Bank, as the premier development finance institution in Africa has a key role to play in facilitating this developmental and financing process.

2. Standard Bank

2.1 Standard Bank is one of the leading African commercial banking and financial service groups, with assets in excess of US\$ 100 billion, and over 45,000 staff in 18 African countries and 20 countries across other continents.

- Listed on JSE Limited,
- Market capitalisation of R103 billion (US\$16 billion in 2005),
- Total assets of R756 billion (US\$ 119 billion in 2005)
- Operates in 18 African countries and 20 countries outside Africa
- Has 746 branches in South Africa, 238 in the rest of Africa.

2.2 The African footprint and Standard Bank wide network in Africa have given Standard Bank a competitive advantage to assist in promoting China/African trade and investment flows.

3. China Export & Insurance Company (Sinosure)

3.1 Since SINOSURE was officially launched and entered into full operations on 18 December 2001, it has successfully set up its organizational structure, consolidated its operational systems and extended its range of services. In support of its goal to establish a modern financial institution, SINOSURE has adopted a streamlined, project-oriented organizational structure and recruited a high-quality team of professionals. More than one – third of SINOSURE's employees have overseas experience. SINOSURE places great importance on the professional development of its employees and aims to foster a culture of continuous learning; individual career development plans are being developed for its staff members.

3.2 As the official Export Credit Agency, Sinosure has been very active in providing PRI and commercial risk coverage to both exporters, contractors, investors and financing banks in relation to trade and investment activities with Africa.

4. The African Development Bank

Functions

4.1 The African Development Bank Group aims to reduce poverty in its regional member countries (RMCs) by contributing to their sustainable economic development and social progress. To this end, it mobilizes external and domestic resources to promote investment in, and provides technical assistance as well as policy advice to, its RMCs. It achieves this objective by financing a broad range of development projects and programs through (i) public sector loans (including policy-based loans), private sector loans, and equity investments; (ii) technical assistance for institutional support projects and programs; (iii) public and private capital investment; (iv) assistance in coordinating RMC development policies and plans; and (v) grants of up to US\$500,000 in emergency support. The Bank prioritizes national and multinational projects and programs that promote regional economic cooperation and integration.

The ADB's African Character and Knowledge of the Region

4.2 Chief among AfDB's comparative advantage among other multilateral development banks is its "Africanness." AfDB is of Africa, in Africa, and for Africa. About 60% of its shareholders come from Africa. All of its operations, including lending and technical assistance, are exclusively for regional member countries (RMCs). Its mandate also calls on AfDB to encourage regional cooperation and integration. The Bank is seen as an institution that understands the continent and its problems well. A governance structure which gives a majority shareholding to borrowing member countries, along with the practice of recruiting a number of its staff members from Africa, gives it a distinct perceived advantage in understanding the borrowing RMCs and their problems. The valued knowledge of this lies in a combination of technical knowledge with knowledge of "how things work" and "what is possible" in the continent. This capacity is being enhanced with the accelerated decentralization exercise, which is establishing the Bank's presence in the countries and complemented by constant flow of missions from headquarters to the countries to address both operational and policy issues, among others.

Concessional Resources, Technical Assistance, and Attractive Financial Terms

4.3 As indicated above, the Bank provides its borrowing countries not only long term financing for large scale projects but also concessional financing, grants, technical assistance, and capacity building that are essential to support the design and implementation of development agendas. The non-reimbursable components of financing have been crucial to support the role of the Bank as a development agency and to promote development priorities agreed by Governors, but not fully internalized into the borrowing requests of client RMCs. Also, although the Bank is not a profit-making institution, it has a strong financial strength as demonstrated by its AAA-rating and standing in the international financial market.

5. Target clients and attendees

5.1 The targeted attendees are major Chinese exporters, EPC contractors and investors to Africa, who have extensive experience and records in African EPC contracts, direct investment, capital goods export and energy exploration. Besides, a few major African mining companies will also join the seminar and explore the cooperative opportunities with Chinese businesses. The total attendees are estimated around 150.

6. Theme and topics

6.1 The topics to be covered include project finance in Africa, FX risks, resource banking and risk protection in Africa etc (see tentative agenda below). After the presentations, open discussions would follow for further of exchange of ideas and exploration of areas for partnership, collaboration, and future business, especially in the areas of trade and investment.

Tentative Agenda

Name: *African Investment, Financing and Risks*

Date: *May 14, 2007*

Venue: *Auditorium, Shanghai International Conference Center, Shanghai*

- | | |
|-------------|--|
| 9:00-9:15 | Opening Remarks,
By Sinosure senior management |
| 9:15-9:30 | China/African Strategy,
By Standard Bank |
| 9:30-9:45 | A Chinese Company's African Experience
By (Sinosure appointed) |
| 9:45-10:00 | African Banking Solutions
By Standard Bank |
| 10:00-10:20 | Project Finance in Africa
By Mr. Jonathon Wood, Director, Project Finance |
| 10:20-10:40 | Resource/Mining, and Banking
By Mr. Andrew King, MD, head of resource banking |
| 10:40-11:00 | Tea & coffee |
| 11:00-11:20 | African Trade Finance
By Standard Bank |
| 11:20-11:40 | Sinosure's Capability in Africa
By Sinosure senior management |
| 11:40-12:00 | African Risk Analysis
By AfDB |
| 12:00-12:20 | Open Discussion |
| 12:20-12:30 | Closing Remarks
By Sinosure senior management |
| | Lunch |

THEMATIC SEMINAR

**AFRICAN'S RE-INDEBTEDNESS FOLLOWING
THE HIPC AND MDRI CANCELLATIONS:
PROPOSALS FOR BETTER DEBT GOVERNANCE**

Concept Paper

Prepared by: *Agence Française de Développement
France*

Date: *14 May 2007*

Venue: *Yellow River Hall
Shanghai International Convention Center, Oriental Riverside Hotel*

Time: *2:30 pm to 4:30 pm*

The purpose of this seminar is to give thought to modalities for the possible re-indebtedness of African states in the current international context, which is characterized by restored RMC creditworthiness owing to the debt reduction (HIPC and MDRI) and the active intervention of new donors such as China. It is as much in the interest of the prospective lenders as that of the borrowers to avoid the errors of the past and the risk of debt default. This seminar seeks to spur fruitful donor dialogue aimed at (i) ensuring good governance of the debt and (ii) taking the risks linked with indebtedness into account in engineering financial instruments.

These two points will be the themes of the panel discussions. Under the second point, AFD will present its ideas concerning an innovative instrument it is currently developing for the African post-HIPC countries, whose payment capacity is extremely vulnerable to exogenous shocks, and which is thus fully relevant to the consolidation of global partnership for development financing in Africa.

1. Background

1.1 From 1996, the International Community embarked on a global process to substantially ease the debt burden of poor countries through the Highly Indebted Poor Country Initiative (HIPC), which for the first time included multilateral debt. Prior initiatives had focused on bilateral debt concerning public creditors (Paris Club) or private creditors (London Club). Beyond the relief, the HIPC objective is to ensure that no low-income country implementing sound economic policies lapses into debt distress.

1.2 The cancellations made it possible to finance poverty reduction expenditure, however the International Community deemed its support to low-income countries inadequate and further cancellations were decided under the Multilateral Debt Relief Initiative (MDRI), concerning approximately 70% of the debt stock of post-HIPC countries.

1.3 The twenty HIPC and MRDI beneficiary countries, with the exceptions of Niger and Rwanda, today have debt levels far below the external public debt sustainability thresholds of the Debt Sustainability Framework for low-income countries (DSF), formulated by IMF and the World Bank. According to the most recent Debt Sustainability Analysis (DSA), twelve of the sixteen African countries that had HIPC and MDRI cancellations are assessed as having a low debt crisis risk level and therefore given the “green light” for the 2007 financial year; two (Ethiopia and Malawi) are rated moderate-risk and therefore “yellow light” countries and, the last two (Niger and Rwanda) are placed in the high risk (“red light”) category (Annex 1, table 2). The low-to-moderate debt risk RMCs have thus fully (green light countries) or partially (yellow light countries) regained their eligibility for concessional lending from IDA and ADF, which base their loan/grant distribution on the debt distress risk as determined by the DSA and in the DSF.

1.4 The context of renewed creditworthiness poses the question of the traditional donors’ financing policy concerning the post-HIPC countries and that of loan modalities, especially for bilateral donors²⁴. These issues are all the more pressing as the financing needs for MDG

²⁴ By a sort of tacit rule, the bilateral donors’ intervention is primarily by grants to the Least Developed Countries (LDCs) and Low Income Countries (LICs), while the multilateral institutions such as IDA and ADF continue to provide loans.

achievement are considerable. The total financing needs for the LDCs and LICs are estimated²⁵ at 135 billion dollars up to 2015.

1.5 Financing through loans is economically more suitable than grants, provided it does not affect the country's creditworthiness and the interest rate applied is below the growth rate of the economy. Indeed, concessional loans allow for higher volumes of financing than grants, when combined with resources raised on the market (volume effect). In addition, the market assessment of LDC risk *de facto* deprives certain countries of access to long-term financing on international capital markets (prohibitive risk premium). It can therefore happen that, for lack of access to loan financing, a country is unable to finance public investments entailing positive externalities, and therefore long-term growth (infrastructure, investment in human capital, health, etc.). In the absence of effective market access, concessional lending makes it possible to ease such countries' liquidity constraints and allows for growth.

1.6 Loan financing can also entail incentives for the beneficiary countries²⁶: the reimbursement obligation may induce greater budgetary discipline (active management of recurrent financial costs) and thus build up country creditworthiness for future access to private financing facilities.

1.7 Lastly, the limited availability of free or concessional finance compared to the current demand obliges some countries to contract new debt on costly and not very transparent terms with the emerging lenders (i.e., not members of DAC or Paris Club) which have no commitment to ensure good governance. Such donors thus benefit from the International Community's collective debt cancellation efforts without themselves having contributed to them (phenomenon of *«free riding»*).

1.8 This context legitimizes the granting of new concessional loans by the traditional bilateral donors, bearing in mind that the previous debt crises emerged despite the soft loans. Certain lessons must thus be drawn from the LDC and LIC debt crises and over-indebtedness that gave rise to the successive debt cancellations, and conditions should be laid down for governance of all fresh indebtedness.

1.9 The decision to grant new loans to LDCs and LICs can only be taken if the multi- and bi-lateral donors have good reason to believe that such indebtedness will not result in new debt crises. Two new types of tools are being put in place to prevent another spiral of loans followed by cancellations:

- At the level of international debt governance: The Debt Sustainability Framework,
- At the donor level: innovative finance instruments to reduce the impact of exogenous shocks on the borrowers' repayment capacity.).

25 Source: UN Millennium Project, Investing in Development, 2005

26 An IMF study (Gupta et al. 2004) assessed the impact of grants as opposed to concessional loans on a country's tax collection efforts, and it would appear that loan assistance translates into greater tax efforts than grants (increased grants result in a decrease in receipts)

2. The Debt Sustainability Framework: A new tool for international debt governance.

2.1 The Debt Sustainability Framework (DSF), formulated jointly by IMF and the World Bank²⁷, aims to set a ceiling for indebtedness, above which the risk of non-repayment becomes very high. It seeks to regulate the post-HIPC re-indebtedness process by limiting its pace, through assessment of the quality of the countries' economic and institutional policies. The countries are placed in three groups based on the nature of these policies (determined by the CPIA score)²⁸: weak, medium and strong. Each country group has its own maximum debt burden thresholds. The DSF debt thresholds are thus determined by the capacity to manage indebtedness as measured by the CPIA.

	NPV of Debt Stock as % of			Debt Service as % of	
	Exports	GDP	Tax Receipts	Exports	Tax Receipts
Poor Rating CPIA <3.25	100	30	200	15	25
Medium Rating 3.25 < CPIA < 3.75	150	40	250	20	30
High Rating CPIA > 3.75	200	50	300	25	35

Source: DSF, IMF/World Bank

2.2 These levels are also used in deciding the IDA²⁹ and ADF loan/grant distribution. Following the Debt Sustainability Analysis, the countries are placed in four categories that determine the percentage of IDA and ADF grant financing:

- Debt-distressed countries: the debt limits defined under the DSF have been exceeded and the country is in arrears;
- Countries highly likely to fall into debt crisis (red light): the ceilings have been exceeded for the baseline debt dynamics scenario. IDA and ADF provide grant financing only. IDA applies a 20% discount on the volumes of financing awarded in accordance with its usual country allocation criteria, so as to reduce the moral hazard;
- Countries with a moderate probability of debt crisis (yellow light): the thresholds have not been exceeded in the baseline scenario but they do not withstand certain

²⁷ IMF/World Bank, *Debt Sustainability in Low-Income Countries: Further Considerations on an Operational Framework and Policy Implications*, September 2004.

²⁸ The Country Policy and Institutional Assessment (CPIA) is an index for rating the quality of a country's policies and institutions. This is measured using an analysis grid with 16 criteria grouped into four equally weighted components: (i) economic management, (ii) structural policies, (iii) policies for social cohesion and equity, (iv) public management and institutions. For further details see: <http://siteresources.worldbank.org/IDA/Resources/ANNEX1CPIA.pdf>

²⁹ IDA has been awarding grants since 2003

shock simulations. IDA and ADF provide 50% of their finance through loans and 50% through grants. IDA applies a 10% discount on the amounts paid, which is lower than in the previous case, as an incentive for countries to change categories;

- Countries with a low probability of debt distress (green light): the ratios are never exceeded. IDA and ADF provide loans only.

2.3 The DSF is being promoted as a tool for coordination amongst donors which should be «adopted» by borrowers: the expectation is that donors will stop lending when the sustainability thresholds have been crossed. Coordination between donors and adherence of borrower countries are the core issues, which raise the broader and yet unresolved question of implementation of the sustainability framework.

2.4 At this stage, the DSF is an information tool developed and provided by the IMF and the World Bank. If it is to secure the support of all concerned and serve as a platform for coordination between donors and borrowers, it must be based on broader consultation between the Bretton Woods institutions, the donors and the countries concerned. The most recent joint IMF/World Bank publication³⁰ represents a step forward in that direction, since the staff clearly mention that other donors stand to benefit from sharing information on the DSA results and underlying assumptions (§62, p.34). They stress the relevance of this request and apparently back it, subject to its acceptance by the authorities of the countries concerned. The staff are also inclined to engage in more regular exchanges with other donors. The move towards enhanced consultation thus seems to have begun.

The goal of the seminar is to strengthen the start of such consultation concerning DSF definition and operational implications for the donors.

3. The Donors' innovative finance instruments: Taking into account the vulnerability of low-income countries

3.1 In developing countries, the debt crises stem at least as much from exogenous shocks (such as price slumps) as from a more structural type of insolvency (Kapur, 2002), relating for example to governance problems. Low-income countries are more affected by shocks impacting their economies than the others.³¹ The volatility of these economies is explained by different factors, such as the variation in the prices of the raw materials that they export or import, climatic hazards, political conflict, etc.

3.2 Any debt strategy not taking this vulnerability into account would be doomed to failure and could even contribute to triggering the mechanisms of an eventual renewed debt crisis. The effect of this volatility on the debt policies of low-income countries is truly a matter of prime importance, since the debt service (foreign currency expenditure) is one of the public expenditure items most likely to be affected by a shock limiting exports (foreign currency resources).

³⁰ IMF/World Bank, *Applying the Debt Sustainability Framework for Low-Income Countries Post Debt Relief*, November 2006.

³¹ Varangis P. ,Varma S., DePlaa A. , Nehru V. *Exogenous shocks in LICs: economic policy issues and the role of the international community*, The World Bank, mimeo, 2004

3.3 If the post-HIPC states choose to further leverage the financing of their economies by extending their debt exposure, how should donors meet this demand without risk of compromising the sustainability of the countries concerned? How can a finance instrument reduce a country's risk of default?

This seminar will provide donors a forum for discussion of this very question: What type of financial instrument can reduce a country's debt default risk?

3.4 AFD for its part seeks to develop an innovative sovereign finance mechanism to adapt the debt service to possible export shocks by a counter-cyclical approach. Such an instrument would make it possible to reduce the debt service in the event of a bad shock. It would avert the liquidity crises leading on to the solvency crises that threaten the international financing mechanism and development financing

4. Organization of Seminar

4.1 The Seminar will focus on the new instrument for international debt governance: the Debt Sustainability Framework jointly developed by IMF and the World Bank. Its architecture and operational implications for the donor community will be discussed. The discussions will also concern the innovative sovereign finance instruments that donors may propose to address the low-income countries' vulnerability to exogenous shocks.

4.2 The panel will be made up as follows:

- AfDB Representative: Louis Kasekende, Chief Economist
- AFD Representative: Pierre Jacquet, Chief Economist and Director of Strategy
- Chinese Cooperation Representative: YU Zhensheng, Deputy Director General Finance Department, Ministry of Finance, People's Republic of China
- IMF Representative: Mark Plant, Senior Advisor in the IMF's Policy Development and Review Department
- World Bank Representative: Vikram Nehru, Director, Economic Policy and Debt Department
- Central Bank of Uganda Representative: Michael Atingi-Ego, Research Director.

5. Some Topics to be Discussed

- How can the economic volatility resulting from external shocks be taken into account in a new indebtedness strategy for African countries?
- How should the lending policies of the emerging donors, who have no obligations to enforce governance aspects, be taken into account for the formulation of a new indebtedness strategy for African countries?
- How can a finance instrument lower a country's default risk?
- What are the operational implications of the utilization of the Debt Sustainability Framework (DSF) for all donors?

THEMATIC SEMINAR

ENVIRONMENTAL CONSIDERATIONS FOR SUSTAINABLE DEVELOPMENT

Concept Paper

Prepared by: *Japanese Bank for International Cooperation (JBIC)
Tokyo, Japan*

Date: *14 May 2007*

Venue: *Yangtze River Hall
Shanghai International Convention Center, Oriental Riverside Hotel*

Time: *2:30 pm to 4:30 pm*

“Environmental Consideration for Sustainable Development”

Seminar of Donors: JBIC-PBC-EDCF-World Bank-AfDB

1. Objectives

1.1 What has been left behind the rapid economic growth? Many countries in East Asian region have experienced rapid economic growth. Japan, as the first wave of such an economic growth in the region, realized high economic growth in the 1960s. Four Asian countries/territories consist of Hong Kong, Singapore, South Korea, and Taiwan are known as “Asian Tigers” for their maintaining high growth rates and rapid industrialization between the early 1960s and 1990s. In the early 21st century, with the original four Tigers at or near to fully developed status, attention has increasingly shifted to other Asian economies.

1.2 Taking the data of average GDP growth ratio per year in the past 25 years (1981 – 2005), many countries’ data in the region shows high growth ratio which is larger than 6.0%.

Country	GDP Growth Ration/year	Country	GDP Growth Ration/year
China	9.8%	Viet Nam	6.9%
Korea	6.9%	Singapore	6.8%
Malaysia	6.2%	Thailand	6.0%

1.3 On the other hand, during such rapid economic growth, many environmental problems were pointed out, such as water pollution, as a negative side of economic growth. Accelerating globalization and the expanding world economy have exposed various environmental issues around the world. Since the United Nations Conference on Environment and Development (the Earth Summit) in 1992, the international community has continuously made efforts to address these issues common for all nations, but Japan and some other countries had to struggle for balancing economic development and environmental conservation even in the 1960s. In this regard, it could be said that the history of economic development is the history of challenge for environmental conservation as well. What have we learned through our experiences and how could the lessons be applied to our future? Now, the environmental problems are not only the issue in the limited region, but have global impact. Environmental problems in the East Asian regions directly and indirectly affect African region, and vice versa.

1.4 Considering such history and background, we proposed to hold a seminar to provide implications for sustainable development in Africa, by sharing lessons learned from the past development experiences in Japan, China, and Korea, mainly in water and forestry sectors.

1.5 It would be timely and significant to explore the theme since many African countries might soon face an acute dilemma between rapid economic development and environmental conservation. In fact, the African Development Bank (AfDB) puts priority on the water sector development.

2. Questions for discussion at the seminar:

- i. What are the strategies that helped Japan and the Asian Tigers in realizing the dramatic growths that are elaborated in the Concept Note, and what were the bottlenecks? What are valuable lessons that Africa can take on board in its stride to development, based on the Japanese experiences?
- ii. Rapid economic development is most of the time challenged with environmental problems. What are the experiences of Japan on this and how can Africa learn from the Japanese experience to develop in an environmentally friendly manner? What could be the challenges and trade offs?
- iii. How can Japan further strengthen its collaboration and ties with the Bank especially in the area of knowledge generation, management and dissemination to ensure that Africa minimizes a repeat of environmental problems associated with rapid economic development?

3. Seminar Outline

- (1) Host Agencies
 - Japan Bank for International Cooperation (JBIC)
 - People's Bank of China (PBC) <TBC>
 - Economic Development Cooperation Fund,
The Export Import Bank of Korea (EDCF-KEXIM)
 - World Bank <TBC>
 - African Development Bank (AfDB)
- (2) Moderator: Mr. Hiroto ARAKAWA, Executive Director, JBIC
- (3) Tentative Program

15 minutes	Opening Speech by JBIC, PBC, and EDCF
15 minutes	Presentation (1) Professor Kazuo UEDA, Kyoto University, Japan <TBC>
15 minutes	Presentation (2) Professor Ma Zhong, Renmin, University of China, China <TBC>
15 minutes	Presentation (3) Professor Jae Shin Ma, Ewha Womans University, Korea <TBC>
15 minutes	Comments by WB, AfDB, and an African Country.
40 minutes	Discussion
5 minutes	Wrap-up by Moderator
<i>Total 120 minutes</i>	

THEMATIC SEMINAR

GROWTH AND RESPONSIBILITY IN AFRICA: PRESENTATION OF THE GERMAN G8/EU PROGRAM AND PANEL DISCUSSION ON SUSTAINABLE PRIVATE INVESTMENT IN AFRICA

Concept Paper

Prepared by: *German Federal Ministry for Economic Cooperation and Development. Germany*

Date: *15 May 2007*

Venue: *Yangtze River Hall
Shanghai International Convention Center, Oriental Riverside Hotel*

Time: *6:15 pm to 7:45 pm*

1. Introduction

1.1 Since the beginning of the year, Germany holds the twin Presidency of the EU (until June 2007) and G8 (until end of 2007). One particular focus of attention of the twin presidency in 2007 is the African continent. The aim of the G8 and EU policies is to continue and to intensify the reform partnership that has been embarked upon with Africa, a partnership that is now showing the first visible signs of success in the fight against poverty. The goal is to continue to improve political and economic conditions in Africa - for sustainable growth in the service of its people.

1.2 The German government and the AfDB agreed to jointly organize a side event which presents the EU/G8 programme and focuses on one particular aspect of the presidential programme: Sustainable Investment in Africa.

1.3 The event consists of two parts: The first part is a presentation of the German twin G8/EU presidency with a focus on the G8 pillar "Growth and Responsibility in Africa". The second part is a panel discussion, focusing in particular on the issue of "Sustainable Private Investment in Africa", one of the key objectives of Germany's G8 Agenda.

2. The G8/EU Framework

2.1 The G8 bears great responsibility for shaping globalization in political, economic and social terms. The German G8 Presidency together with its G8 partners plans to address this challenge and strives to improve the environment for a dynamic, fair and sustainable development of the global economy. Against this background, Germany made "Growth and Responsibility" the heading of the G8 agenda for 2007.

2.2 Africa is developing dynamically. Economic growth has picked up in the majority of countries, democratic governance is increasingly becoming the continent's standard, African institutions at the national and regional levels are ably working towards African political and economic integration, and positive terms of trade developments are supporting Africa's participation in worldwide trade and investment. In spite of these overall positive trends, the continent still faces unique challenges: widespread poverty, the HIV/AIDS pandemic and some prolonged and complex conflicts.

2.3 Despite these challenges, the G8 message of this year is a message of confidence, signaling that it is the right time to increase private investment in Africa, and a good opportunity to accelerate and sustain economic growth. More domestic and foreign investment is needed to increase growth and substantially reduce poverty rates; more investment is feasible taking advantage of the political, legal and institutional reforms undertaken in recent years, and of the opportunities of abundant African human and natural resources. More investment is also needed to continue the structural transformation of African economies. But it has to be sustainable investment in Africa, sustainable and responsible in social, generational and ecological terms, investment patterns which meet international standards.

3. Contents of the Seminar

3.1 The seminar will provide a forum to discuss and deepen understanding of the following questions related to the sustainability of the private investments in promoting shared growth in Africa:

- i. What are the dimensions of sustainability of private sector investments?
 - financial aspects (risks and opportunities of investments in Africa, remaining obstacles for FDIs);
 - development aspects (importance of job creation, tax revenues, corporate social responsibility activities);
 - ecological aspects (importance of World Bank Standards, Equator Principles);
 - social aspects (ILO Standards);
 - aspects of good corporate governance (Extractive Industries Transparency Initiative EITI)
- ii. What is the role for bilateral donors, what is the role for Development Banks like AfDB and DEG?
- iii. What are good examples for sustainable investments and what are possible benchmarks for future FDIs?

4. Organization of the Seminar:

4.1 The Seminar will consist of two parts:

- a. The German Governor and Junior Minister in the German Ministry for Economic Cooperation and Development Karin Kortmann will present the German EU/G8 twin presidency programmes.
- b. Subsequently, a panel discussion will focus on one particular aspect, namely “Sustainable Private Investment in Africa”. Panel members are:
 - Dr. Donald Kaberuka, President of the AfDB
 - Mr. Trevor Manuel, Minister of Finance, South Africa
 - Mr. Winfried Polte, Chairman of the Management Board, DEG (double role as Moderator and panelist)
 - Representative of the Chinese Council for the Promotion of International Trade (CCPIT) (to be confirmed)

5. Target Audience

5.1 Governors, Participants of the Annual Meetings, representatives from Africa including representatives from the business community, representatives from China and other Asian countries active in Africa; (Development) Finance Institutions.