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Overseas Development Institute

Briefing Paper

April 1992

THE AFRICAN DEVELOPMENT BANK: FACING NEW CHALLENGES

The African Development Bank (AfDB) is a major financial institution in a continent with weak economic performance. Euromoney named it Supranational Borrower of the Year in 1991. Yet despite its high credit rating, there are concerns that its lending strategies will remain immune to the economic problems of the continent. The Bank has a regional vocation although regional economic integration in Africa has been rather unsuccessful. It needs to balance the demands for project and policy loans from the regional members with the financial concerns of non-regional members. It must also cope with and facilitate major changes in Southern Africa as well as recovery in the rest of Africa. This briefing paper examines the changing nature of the AfDB in the 1980s and 1990s. It is the second in our series on the regional development banks.

History

The AfDB was founded in 1964 and has its headquarters in Abidjan. It was established by 33 African countries, many of which had only recently achieved independence. The founder members wanted to establish an institution that could specialise in African problems and that would be under African control. They were particularly concerned to create an institution that could overcome the economic constraints that result from the small size of many African economies. Consequently, the African Development Bank has always supposedly given preference to loans that would benefit more than one country.

In order to avoid control by the former metropolitan countries, the initial share capital of $250m was entirely subscribed by independent African nations. In addition the top management, board of governors and board of directors were wholly African. However, it soon became apparent that to make a significant contribution to the development goals of the member states the Bank would need a supply of concessional finance and a capital base in excess of what the member states could provide. As a result in 1973 the African Development Fund (AfDF) was established which admitted non-African countries for the first time.

The Fund provides finance on concessional terms to member states. The Fund's resources comprise subscriptions from the Bank and grants from non-regional participants and are dependant on replenishment every three years. AfDB funds are on-lent to regional members on highly concessional terms (fifty year repayment period, no interest rate but a 0.75% service charge).

The Bank eventually took the decision to accept non-regional members as full members of the Bank in 1982. This gave a minority voting power to governments outside Africa. The Bank's members now include all African countries other than South Africa and 25 non-regional members. A list of the major contributors is shown in Table 1.

Lending Trends

The resources of the Fund and the Bank have risen sharply since 1976 (see Table 2). By 1990 the Bank had raised a total of US$ 5,064m on the world capital markets in addition to member country subscriptions, while cumulative contributions to the fund stood at US$ 7,872 m. Approved lending by the Bank group (the Bank and the Fund) reached US$ 3.3bn in 1990 (disbursements US$ 1.9bn), bringing cumulative approved lending to US$ 18.8bn (disbursements US$ 8.7bn). Total disbursements by the Bank stood at US$ 5,413m in 1990 compared to US$ 3,065m for the Fund.

In 1990 approved lending to sub-Saharan Africa was equivalent to two thirds that of the World Bank, while in North Africa resource flows from the two institutions are now comparable. The Bank is active in the co-funding of projects with both multilateral and bilateral institutions. At the end of 1989 the Bank had concluded co-operation arrangements with 18 non-regional countries and with about 30 multilateral institutions including 10 African-based regional organisations. AfDB's resources are allocated broadly according to the size and GNP of the member states. Countries are divided into 3 main categories according to GNP per capita with concessional funds (AfDF) being targeted at countries in category A: (GNP per capita of less than US$510). In 1990 category A countries received 82% of all AfDF loans approved, with a further 17.3% going to countries in category B (GNP per capita of between US$511 and $990). In 1990 the largest borrowers from the AfDB were (in descending order) Egypt, Nigeria, Algeria, Zimbabwe and Côte d'Ivoire. The main borrowers from the AfDF were Tanzania, Uganda, Malawi, Ghana, Nigeria, Senegal and Sudan (For cumulative lending patterns see Figure 1). The sectoral distribution of loans has changed over time. Despite the early emphasis on regional integration, multinational projects have never absorbed more than a fraction of the Bank's resources. One of the obstacles to loan-funded multilateral projects is that countries need to agree on the division of repayments which requires agreement on the likely distribution of benefits. The AfDB

Table 1: Subscriptions by main AfDB Members
(as at 31 December 1990)

	Bank (%)	Fund (%)		Bank (%)	Fund (%)
Regional Members			**Non-Regional Members**		
Algeria	3.6		Canada	3.3	9.9
Côte d'Ivoire	2.8		France	3.3	7.7
Egypt	6.2		Germany	3.6	9.1
Ghana	2.5		Italy	2.1	7.7
Libya	4.9		Japan	4.9	14.2
Morocco	3.6		UK	1.5	3.7
Nigeria	10.7		USA	5.9	13.3
Zaire	4.8		Others	10.5	32.4
Zimbabwe	2.8				
Others	23.0				
Total	64.9	2.0	Total	35.1	98.0

Source: AfDB; *Annual Report*, 1990.

Table 2: Growth of Resources (US$ m)

	Fund[a]	Bank[b]
1979-81	811	375
1982-84	1,071	795
1985-87	1,795	2,407
1988-90	2,825	5,064
1991-93	3,340	

Notes: [a] Replenishment of the Fund
[b] Gross borrowings, at end of period
Source: AfDB, *Annual Report*, 1990

has tried to give priority to agriculture, in recognition of the central role it plays in the economies of all the Bank's regional members but recent lending has fallen short of the declared target of 40%. Lending for education and health are a small part of the Banks's activities as few countries are willing to borrow at commercial rates for such purposes. However expenditure in these areas constitutes a significant part of the Fund's lending (Table 3). More controversy has arisen over the extent to which the Bank and its Fund became involved in policy-based lending in the late 1980s although this has been reduced since 1990.

Growth in Lending

The recent growth in lending has raised important questions about the Bank's lending strategy. At the last General Capital Increase in 1987, the President pushed for and achieved a doubling of the capital base. This enabled the Bank to triple its borrowing on international markets. However the non-regional members have voiced concern over the Bank's ability to manage the increased funds and to find sufficient viable projects. They doubt the absorptive capacity of the Bank's clients, many of whom are heavily indebted and are obliged to seek regular rescheduling of their existing debt. Capital made available from the Bank through the 'hard window' carries an interest rate of about 8% and at this rate it is not clear how many countries will be able to keep up their repayments. The cost of arrears to the Bank has steadily risen and in proportion to total loans they are now higher than for any of the other multilateral development banks. The number of countries unable to receive new loans from the Bank, due to arrears, stood at 20 in 1989. The corresponding number under such sanctions with the Fund rose to 18. Given these trends the non-regional members have criticised the lack of country risk analysis and the Bank's reluctance to deduct provisions for bad loans from the annual profit statement.

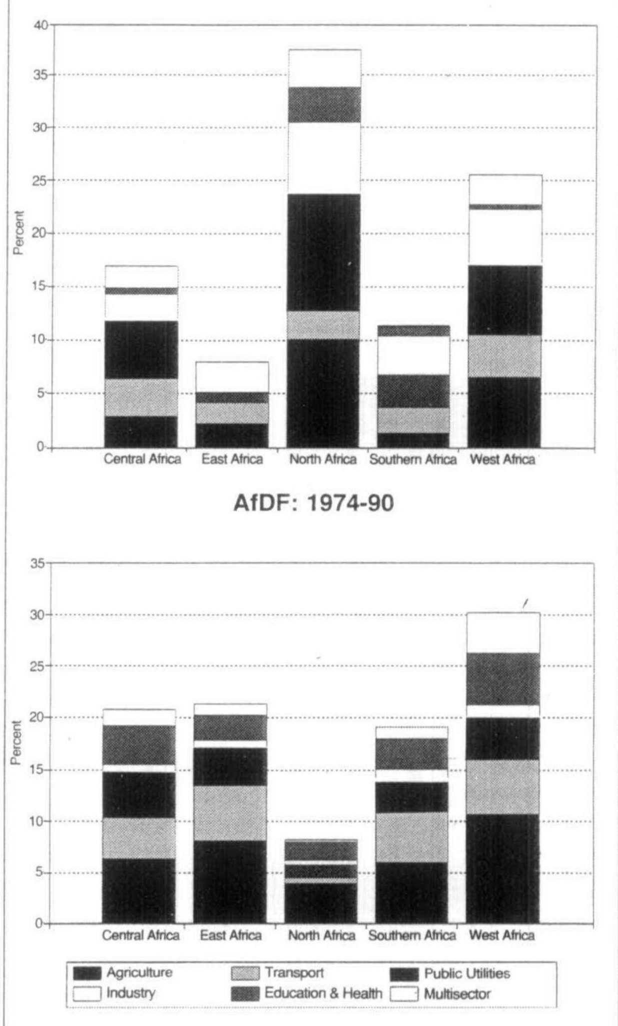
Despite these criticisms, the management of the Bank maintains that they should maximise resource flows given the urgent needs of the continent, the support of its regional members for increased lending and the decline in the flow of private capital to the region (see Table 4). Besides, further loans cannot be made to any country that is not current on repayments of previous loans. The Bank also cites its high credit rating as evidence of its continued credibility in international markets which has enabled it to sell new issues with little difficulty. The Bank's credit rating reflects the fact that the AfDB only lends to sovereign governments and is supported by guarantees from all its members that the necessary capital can be called upon in the event that it should be unable to honour the terms of its bonds. However, the debt crisis has dispelled the notion that sovereign governments cannot go bankrupt, and the members have strong reason for wishing to avoid having calls made on their capital.

The controversy could be resolved if more of the growth in lending were taking place via the concessional 'soft window' of the Fund rather than at commercial rates from the Bank. However donors have been increasingly reluctant to increase their subscriptions to the Fund. The sixth replenishment of the Fund in 1991 achieved a 17% increase (US$3.34bn), which in real terms is only 4% higher than OECD inflation. This was only made possible by an increase in Kuwait's contribution, in recognition of the costs borne by African countries during the Gulf War. The three largest donors, Japan, the United States and Canada, all signalled their desire to reduce their financial contribution to the Fund. Only a few non-regional members, notably France, the Netherlands and Norway argued for an increase in the Fund.

New Lending

The continuing economic problems of many African countries have curtailed the number of viable projects of the type with which the Bank is most familiar. Instead the Bank has become more involved in policy-based lending (see Table 3) in which loans are used for the purpose of supporting structural reform in the economies of member states. From negligible proportions, such loans increased to almost a third of the Bank's lending in 1987, although they fell back in 1990. Unlike the Inter-American Development Bank, the AfDB was quick to adopt this type of lending in the 1980s. Given the debate within Africa as to the appropriateness of structural adjustment programmes of the World Bank and International Monetary Fund, regional

Figure 1: Cumulative loan and grant approvals
AfDB: 1967-90



members and the Economic Commission for Africa (ECA) have suggested that the AfDB should provide African countries with an alternative to the tough deflationary measures required by other multilateral bodies. However no such AfDB innovation has been forthcoming, although it is widely recognised that structural adjustment programmes have had a more mixed record of success in Africa than elsewhere in the developing world. Critics of the AfDB have argued that the design of structural adjustment programmes requires an in-depth understanding of the structure of the economy concerned and that in many cases the Bank lacks the required expertise.

The financial implications of policy-based lending are considerable. The success of the Bank's involvement with such lending depends on both the willingness of political leaders to comply with the efficiency conditions established by the Bank and the effectiveness of the supply response that results from structural adjustment. Africa's growth prospects during the 1990s still look uncertain. If structural adjustment does not achieve the desired supply response, policy-based lending by the AfDB may simply increase the debt burden of many African governments. The external debt of many African countries has more than tripled in the last ten years (Table 4). Prices of Africa's export commodities have yet to recover from the downturn of the 1980s. Since 1985 only copper has staged a recovery from the deep slump of the previous five years, and tropical beverages remain chronically depressed.

Despite recent debt reduction initiatives, future scheduled debt service in many AfDB member states remains far in excess of debt service paid in recent years. Even the World Bank now declares that in many sub-Saharan African countries the debt overhang is so pervasive that it threatens the process of adjustment (World Bank; *World Debt Tables*, 1991-92). To deal with the debt problem, the AfDB has created a Debt Management Unit to monitor African debt, and to assist regional member countries in formulating appropriate debt alleviation strategies. The Bank has been active in promoting external debt refinancing schemes.

Conflicts Within

The AfDB is smaller than its Latin American or Asian counterparts and still has to resolve many important political issues concerning its scope and responsibilities. Unlike other regional development banks the AfDB has not yet established a reputation for specialised knowledge of the economies of member countries. One of the problems has been the shortage of African expertise. This problem was exacerbated by two policy decisions. Firstly, before 1983, salary levels were not internationally competitive. Secondly employment was officially confined to citizens of regional (African) countries, although external consultants and technical assistance experts have always played a significant role. The AfDB stood in marked contrast to the other regionals in this respect. In 1986 the Bank made the first tentative steps to recruiting outside the region. The president is also chosen from one of the borrowing countries, unlike the World Bank or the Asian Development Bank. Within the voting structure of the Bank, members have tended to form sub-regional and linguistic power blocks; North Africa, Francophone Africa, Anglophone Africa and Nigeria, and each group has insisted that it is granted one of the vice-presidencies, which have become largely political appointments. More recently the non-regionals have come to constitute a fifth block with a non-African vice president. The Bank has thus travelled far from its initial aim of closer African economic integration.

The issue of recruitment strategy and the allocation of the vice-presidencies highlights the deep-rooted concern of the regional members to maintain the African character of the Bank. This is further reflected in the voting structure under which regionals control 64% of the votes in the Bank and 50% in the Fund. Repeatedly, policy deliberations within the Bank divide between regionals and non-regionals. The former are frustrated by their dependence on foreign capital and expertise, whereas the latter are concerned that the financial health of the Bank will take second place to the development aspirations of the regional members. While the Bank needs to be financially responsible to all its members the AfDB wants to be seen as Africa's own Bank and is expected by some to be more sympathetic to local conditions.

In 1990 the President (Babacar N'Diaye), a Senegalese, was re-elected for a second five year term. For the first time since 1970 the AfDB can therefore look forward to a period of continuity during which an experienced president can push ahead with a programme of changes.

Table 3: Sectoral Distribution of Loans (%, rounded)

	Bank			Fund		
	pre-'87	'87-89	'90	pre-'87	'87-90	'90
Agriculture	25	22	17	38	32	29
Transport	20	13	7	23	19	16
Public Utilities	28	23	34	20	11	15
Industry	20	17	29	2	7	7
Education & Health	6	5	4	15	15	20
Multisectoral	-	18	10	1	17	14
Total	100	100	100	100	100	100
Policy Based	-	31	18	-	18	16

Source: AfDB, *Annual Reports*, various years.

A Wider Role

During the 1980s the AfDB increased its sphere of influence in many areas and has set up sub-units within the Bank to tackle specific policy issues of concern to Africa. These include tacking an active role in promoting the private sector, through both equity participation and direct lending and addressing the debt problem, with the establishment of the AfDB External Debt Initiative and Debt Unit. At the May 1992 annual meeting the President of the Bank is expected to support doubling the proportion of the Bank's resources that are devoted to the private sector (from 15% to 30% of the Bank's portfolio).

During the 1990s the Bank also aims to place an increasing emphasis on the environment. In the negotiations for the sixth replenishment of the Fund (AfDF VI) the Bank made a commitment to conduct environmental impact assessments and to make these available to the Board of Directors before they are asked to approve a loan. Gender issues are attracting greater attention within the Bank and a Woman in Development Unit has been established. However, the most immediate challenge is the emergence of a post-apartheid South Africa.

The AfDB and South Africa

There is considerable debate over the extent and type of financial institutions that should evolve to link a post-apartheid South Africa and the rest of the subregion. It has

Table 4: External Debt Indicators: Sub Saharan Africa[a] (US$ millions and percent)

	External Debt Stock				Long Term Financing (Gross Flows)[b]	
	Amount 1980	%	Amount 1990	%	Amount 1990	% Change since 1980
Total external debt	56.3	100	173.7	100		
Long term	46.6	83	152.8	88	4653	-47
Official	27.2	48	112.0	65	4325	-3
Multilateral	10.6	19	43.5	25	2911	27
Bilateral	16.7	30	68.5	39	1414	-34
Private	19.4	34	40.9	24	328	-92
Short Term	9.7	17	20.9	12		
of which Interest arrears on long term debt	0.2	0	10.5	6		

Notes: [a] AfDB covers North Africa as well as Sub Saharan Africa [b] Total net debt related flows on long term debt
Source: World Bank, *World Debt Tables 1991-92.*

been suggested that in addition to eventual membership of the AfDB there is a need for either a sub-regional development bank or fund to facilitate regional development and the economic restructuring that will occur in the subcontinent as a result of the reintegration of South Africa.

Speaking at the last general meeting of the Fund, an AfDB vice president reiterated the Bank's view that dialogue on economic grounds must be preceded by a political settlement and that South Africa's formal membership of the Bank requires approval from the Organisation of African Unity. In April 1992 the president of the Bank made his first official visit to South Africa, meeting Nelson Mandela and President De Klerk. He declared that the AfDB would consider financing South African development as soon as a multiparty interim government was 'in place'.

South Africa has never been a member of the Bank and already has its own, largely domestic, development bank: the Development Bank of Southern Africa (DBSA). Founded in 1983 by the South African government the DBSA was originally established to provide development finance to the Bantustans of South Africa. Although membership was open to any independent Southern African state, political considerations and the lack of an appropriate funding structure and constitutional arrangements have limited the involvement of other African States. Only Lesotho, Mozambique and Namibia have had links with the DBSA. Until 1990 the DBSA was largely reliant on a state grant. Since then capital has been raised from bonds issued on domestic and international capital market, although grant funding from the South African Ministry of Finance continues.

The nature of the links that develop between South Africa and the AfDB and between the DBSA and the AfDB will depend partly upon the evolution of political and trading links between South Africa and other African states. For example, trade liberalisation in the subregion may result in calls for a compensatory fund to offset the negative impact of trade liberalisation on some countries. There is also a need to co-ordinate investment finance within the region. It is unlikely that the frontline states would wish the DBSA to assume these roles, especially at the expense of existing Southern African Development Coordination Conference (SADCC) or Eastern Southern African Preferential Trade Area (PTA) structures, especially if the DBSA retained and increased its responsibilities for the provision of development finance within South Africa. Furthermore, the African Development Bank, like the World Bank, wants to establish and maintain a presence throughout the continent.

Conclusion

The Bank has made significant improvements in its management and lending practices, but it still needs to reconcile the interest of the non-regional and regional members. With the continued support of the non-regional members, the African Development Bank is likely to be providing an increasing proportion of the funds to underpin any economic recovery in Africa. Yet the Bank's involvement in policy-based lending means that its financial health will depend on the success of the structural adjustment initiatives currently under way in its African regional member countries. If structural adjustment does not result in an early improvement in economic performance, many countries may find it increasingly difficult to keep up with interest payments on the large volume of new lending from the mid-1980s, which will start to come due during the 1990s. If the growth in lending does slow down, the net transfer of resources between member states and the Bank could turn negative for many countries, especially in sub Saharan Africa, decreasing the incentives to honour their debts.

This Briefing Paper draws on a Briefing from the North-South Institute (Ottawa): *Ahead from the Lost Decade: The African Development Bank gathers strength.* We are grateful for permission to use some of their material.