SEMINAR REPORT

Forging Links:

Economic Research and Policy Making in Sub-Saharan Africa

Report of the 1995 Senior Policy Seminar

by
Matthew Martin
External Finance for Africa

and

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AFRICAN ECONOMIC RESEARCH CONSORTIUM
CONSORTIUM POUR LA RECHERCHE ECONOMIQUE EN AFRIQUE

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Nairobi,
October 1995

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1. Introduction

Participants, Aims and Objectives of the Seminar

The first senior policy seminar sponsored by African Economic Research Consortium (AERC) was held in Nairobi on 30–31 March 1995. It was attended by 49 participants, including 25 African policy makers from 13 countries (Botswana, Ethiopia, Ghana, Guinea–Bissau, Guinea–Conakry, Kenya, Mozambique, Nigeria, Senegal, Tanzania, Uganda, Zambia and Zimbabwe). These included one central bank governor, one former governor, one vice–minister, three deputy governors and many other staff of general manager, director, deputy director level from central banks, finance ministries and planning ministries.

The policy makers were specifically identified for their interest in policy research issues. They came from countries that had been a focus of AERC research or at least had experience of substantial macroeconomic reform (while maintaining a linguistic and sub–regional balance). All policy makers invited initially accepted but unfortunately, due to last minute IMF/World Bank missions, four were unable to attend. A complete list of participants is attached as Annex B.

The seminar had four aims:

- To identify possible areas of policy–oriented research for AERC–funded researchers to consider;
- To improve prospects for policy involvement by AERC–funded researchers;
- To increase AERC visibility in the policy community, highlighting the growing capacity in the region for policy research; and
- To provide an opportunity for policy makers and researchers to exchange their experiences of and views on macroeconomic policy.

These were achieved in four ways:

- By synthesizing and disseminating the results of AERC–funded research to senior policy makers;
- By generating an interaction between the policy makers and AERC–funded

researchers on the results of existing AERC research;
- By encouraging sharing of experiences among policy makers on the lessons and details of macroeconomic policies; and
- By receiving feedback from policy makers on the key current policy–related research issues in Africa.

The concrete outputs of the seminar were expected to be:

- Major input into AERC's policy–oriented research agenda, in the form of suggestions for key priorities in each of the policy areas examined;
- Ideas for methods and structures to promote closer collaboration among policy makers and researchers, both within individual countries and collaboratively across the continent;
- Wider dissemination of AERC materials to policy makers, and ideas for forms and methods of dissemination most convenient to them; and
- Proposals for how to follow up the seminar.

Content and Structure

The two-day workshop began with a formal opening by the Deputy Governor of the Central Bank of Kenya, Dr. Thomas Kibua, and the AERC Executive Director, Professor Benno Ndulu. The workshop programme is attached as Annex A.

This was followed by five substantive sessions. The first three were organized around themes in which AERC has already produced a major body of policy–oriented research: exchange rate policy; fiscal and monetary policy and inflation; and financial policy. For each theme, one or two AERC researchers presented a background paper which synthesized the results of AERC and other recent research. The fourth session examined the wider overall macroeconomic research agenda (especially the design of macroeconomic policy programmes), focusing on the recent experience of exchange rate appreciation in Uganda. The fifth examined the process of interaction between policy makers and researchers, drawing on the AERC policy study by Joseph Hoffman.

After each presentation, the paper was discussed by between one and three discussants, ensuring a balance between policy makers and researchers and between anglophone and francophone discussants. The comments were followed by floor discussions by the policy makers in which they commented on the papers, exchanged their experiences in designing and implementing policies and highlighted the key issues raised for policy–oriented research.

Next, the meeting divided into working groups to ensure that each policy maker had a chance to express detailed ideas, and to identify the consensus within each group on the priority outputs of the seminar (policy research issues and follow–up mechanisms).

There were four groups: francophone, anglophone east, anglophone west and anglophone south. The results of the working groups were presented to a final plenary session and, following a response by Dr. Ibrahim Elbadawi, AERC research coordinator, the meeting was closed by Prof. Benno Ndulu and the Deputy Governor of the Bank of Ghana, Mrs. Nana Yeboaa. In addition, the participants were asked to complete a questionnaire by evaluating the content and organization of the seminar, and by making proposals for key research areas and follow–up mechanisms.

The rest of this report is organized as follows. Part 2 consists of the opening speech by Dr. Kibua. Parts 3 to 7 present summaries both of the papers presented and of the discussant's comments and floor discussion in each session. Part 8 summarizes the working group conclusions and Part 9 the participant evaluations of the seminar. Part 10 contains follow–up recommendations for implementing the conclusions.

Summary of Conclusions and Recommendations

Dr. Thomas Kibua, Deputy Governor of the Central Bank of Kenya, opened the seminar by stating how important it was for policy makers to be aware of the research available and how it can be utilized to the benefit of each country's agenda. The interaction between economic researchers and economic policy makers is vital and needs whole-hearted encouragement.

Together the two groups listened and discussed issues of mutual interest – problems in need of answers so that policy can be directed both by research and practical experience. The policy makers held a wide range of responsible positions. There were central bank governors and deputy governors, directors of research and their assistants, and top officials from ministries of finance and economic planning, including one deputy minister. These men and women listened to the AERC researchers who presented syntheses of research on several topics of vital interest and importance to the policy makers. These included: exchange rate policy, fiscal and monetary policy and financial policy. One major session encompassed a broader macroeconomic research agenda, particularly the design of macroeconomic policy programmes. The concluding session focused on the process of interaction between policy makers and researchers.

Discussions were lively and indicated clear interest and appreciation on both sides. The researchers were eager to hear reactions to the work and suggestions of further research in order to improve their policy involvement. The policy makers were keen to make use of the existing research, a large portion of which had been condensed into executive summaries for their use. They also saw the seminar as a unique opportunity to exchange candid views with one another and to realize that their countries had similar policy environments and problems which could derive solutions from sharing experience.

Sorting out priorities

After one and a half days of detailed presentations and fruitful discussions, the participants formed four working groups based on geographical areas within sub-Saharan Africa: francophone, anglophone west, anglophone east and anglophone south. Each comprised both researchers and policy makers.

From these groups, from the discussions within each session and from the seminar evaluations, there emerged a set of priority research issues:

- The role of exchange rate policy in a liberalized economy, especially the scope for intervention in forex markets;
- The process of budget formulation and execution, particularly new sources of revenue mobilization;
- The implementation of indirect monetary policy;
- How to encourage investment in production (with the emphasis on medium, small and micro enterprises) through enhanced financial sector reform, and the encouragement of informal financial markets;
- The role and credibility of government; and
- Macroeconomic responses to external shocks from excess or insufficient external capital flow.

How to study these topics needs careful consideration to ensure a clear and productive division of labour among researchers and policy makers. Researchers could contribute surveys of literature and of non-African experiences, theoretical background papers, econometric modelling and sample surveys of private sector reactions to a variety of policies. Policy makers could identify key issues in each country to ensure policy relevance, and analyse government data, institutional capacities and current policy thinking.

Many other topics and sub-topics suggested would best be pursued by sub-groups of countries, or policy makers and researchers. They could be fed into any future design of projects in these areas by AERC researchers to make them more policy relevant.

A questionnaire was completed by the policy makers at the end of the seminar, evaluating its utility and suggesting improvements. The overall evaluation was extremely positive: one said it had been an "eye-opener" about AERC and the potential for cooperation among policy makers and researchers.

- Every policy maker found the seminar worthwhile due to interaction with the researchers and the exchange of experiences with other policy makers.
- All would attend another seminar, though their priorities for topics varied. Around half wanted a seminar on the financial sector, on fiscal and monetary policy or on relative roles of government and private sector; other popular

subjects were regional integration and trade promotion, overall macro-micro policies and links, and exchange rates.

- All wanted to pursue joint research projects with researchers. The top priorities were exchange rate policy, expanding fiscal revenue and overcoming financial sector distress. Other prominent issues were the role of government in a liberalized economy, macroeconomic sequencing, indirect monetary targets and policy, how to finance SMEs innovatively, investment and savings, private sector promotion and privatization, capital flows and external shocks, and informal finance.
- All participants indicated they would be more likely to use AERC researchers and research materials in future policy-relevant research.
- With one exception, they agreed that the research presented had added to their knowledge of policy issues, especially through the informal financial sector and overall macro agenda papers.
- Again, with one exception, they agreed that the seminar had suggested mechanisms for interaction among policy makers and researchers in their own countries, including joint research, seminars, staff exchanges, cooperation in "policy units" or working groups, production and dissemination of executive summaries and data collection.

Dissemination into the future

The seminar was an extremely successful mechanism for disseminating knowledge of AERC's aims, procedures and products to policy makers. Both the seminar papers and the executive summaries of existing papers were very well received. The seminar was small in order to enhance fruitful discussion, and therefore reached relatively few policy makers. To disseminate the seminar results and future AERC products to a wider network of policy makers, several avenues were suggested for the AERC secretariat:

- Produce three written outputs from the seminar itself: a very brief summary of the seminar; an edited version of the seminar report; and a full volume of proceedings, including the text of the papers presented. Each would target different audiences: the first would be useful for senior policy makers; the second for seminar participants, research-oriented policy makers and AERC researchers; and the third for all those interested in policy-oriented research areas.
- Create a directory of the researchers in its network, with their research interests, highlighting those interested in policy issues, and circulate it to African research institutions and governments.
- Make all possible efforts to widen the group of enthusiastic policy makers created by the seminar into a permanent network of Africans interested in policy research. Each of the policy maker and/or researcher participants in the seminar could act as a "contact point" to name other research-oriented policy makers in their country, particularly those in planning commissions and policy units, and to disseminate AERC outputs.

- Ensure that more of its researchers are informed of the results of the seminar, in order to involve them in follow-up projects. It might consider devoting a plenary day or half-day to presenting the papers or discussions at the senior policy seminar.
- Organize more national policy workshops, and highlight the conclusions of the policy seminar (and any follow-up policy research projects) in such workshops.
- Strengthen links with francophone policy makers. Contacts would be made with BCEAO and BEAC, to organize a presentation of the results of this senior policy seminar, and to discuss cooperation on policy-oriented research (especially given the seminar findings that almost all issues were similar for CFA and non-CFA countries).
- Lusophone policy makers and researchers are particularly poorly served by research networks and AERC should remedy this gap urgently.

All the participants expressed the strong hope that AERC would organize similar seminars in future, focusing more closely on individual issues and research projects. Several participants expressed their gratitude to AERC for giving them such a valuable opportunity. To quote one policy maker, "We all came away different". The researchers also had a first time opportunity to engage in real dialogue with those who design and implement policy – they were "a window to the real world".

2. Opening Session

Opening remarks by Dr. Thomas N. Kibua Deputy Governor Central Bank of Kenya

The executive director, distinguished participants, members of the AERC, ladies and gentlemen

First, I would like to express my appreciation for the invitation extended to me to officially open this seminar. Before touching on issues relevant to the theme of the seminar, let me take this opportunity to thank the sponsors and AERC for convening this workshop. It is an important forum because it will enable participants to exchange views and experiences on macroeconomic policy issues, particularly those arising from the structural adjustment programmes being implemented by most African countries.

During the late 1970s and most of the 1980s, sub-Saharan economies experienced serious economic and financial difficulties. These manifested themselves in high inflation, inability to balance external obligations with external receipts, protracted economic stagnation and worsening poverty conditions. These economic problems were partly due to such exogenous factors as unfavourable terms of trade and poor weather conditions. However, the main underlying factors were structural bottlenecks associated with the inappropriate economic policies pursued in the first 20-25 years of their independence.

In recognition of these difficulties, several African governments have implemented structural adjustment reforms in order to improve the adaptability and flexibility of their economies so as to reverse the downward trend in growth. Both macro and microeconomic reforms have been implemented. The macroeconomic aspects entail ensuring that there is a stable macroeconomic environment for structural reforms to take root. In this regard, reforming economies have taken measures to reduce imbalances between overall supply of goods and services and their demand. The imbalances have manifested themselves in rising inflation and unsustainable balance of payments deficits. Unsustainable balance of payments have in turn taken the form of shortages of foreign exchange and the associated build-up of external debt arrears. Measures to address these problems in the context of structural reforms include tight fiscal and monetary policies to:

- Reduce government expenditure on various items including subsidies;
- Broaden the tax base; and
- Tighten conditions for availability of credit to restrain monetary expansion.

These measures are designed to provide the macroeconomic framework for improving the productivity of the private sector. The reforms persistently pursued are expected to pull the economies out of their present state of economic stagnation and poverty. The major structural reforms include:

- Removal of price controls
- Liberalization of marketing of agricultural and petroleum products
- Removal of import licensing
- Liberalization of current and capital accounts of the balance of payments
- Removal of control on exchange rate
- Liberalization of interest rates
- Removal of quantitative credit controls
- Introduction of indirect monetary policy instruments
- Strengthening of supervisory capacity of central banks
- Restructuring of weak financial institutions
- Privatization and restructuring of public enterprises
- Rationalization of civil service

The reforms have considerably enhanced the investment environment of our economies. Although their full impact is bound to take time, notable gains have been made in restoring macroeconomic stability, and in some countries prospects for renewed growth are high. For example, the high inflation that characterized most economies has been reduced while the level of foreign exchange reserves in terms of months of import cover has risen.

The reforms have, however, generated new challenges, which must be addressed promptly if we are to consolidate the gains already made and ensure further progress. I wish to illustrate these challenges with Kenya's experiences with which I am more familiar.

- We have in the last two years pursued a tight monetary policy in order to reduce inflation from the high levels that prevailed in mid-1993 to the single-digit range. We have used mainly the cash ratio and open market operations (OMO) instruments of monetary policy. We have been using treasury bills as the main instrument for OMO. To get people to invest in this instrument, we had to offer attractive yields. Consequently, the yield, which was about 17% in February 1993, rose to 71% in July 1993. Although the rate has since come down substantially, the increase made the task of managing fiscal policy very difficult. Interest payments on domestic debt took about 44% of government recurrent revenue in FY 1993/94. This meant we had to reduce capital and other recurrent expenditures in order to ensure that the overall budget deficit remained within the level consistent with the macroeconomic objectives we had set to achieve.

- The high yields on treasury bills also led to large capital inflows as people who previously held funds abroad brought them back to cash in on the high returns. This complicated the management of monetary and exchange rate policies. Because these capital inflows could not immediately be absorbed by the economy, they led to sharp appreciation of the shilling. While this development has certainly been welcomed by the importers and consumers, exporters have not been amused as it has led to a reduction in their earnings. This poses a challenge to researchers as well as those responsible for economic management. There is need to improve our techniques of exchange rate management so that we maintain a rate that will spur production of exports and import substitutes without putting undue pressure on domestic prices.

- Another area of concern is the failure of interest rates to respond quickly to the decline in inflation. Despite the sharp fall in inflation from the three digit level prevalent in June 1993 to a single, digit level presently, lending rates have barely come down. Banks are currently charging on average 25% per cent for their loans, allowing a spread of 10%. This is excessively high and poses a major constraint to expected expansion in investment. There is need to know what could be done within a liberalized framework to have banks reduce their lending rates.

- The opening of our economy has generated competition for local industry. While this may enhance efficiency, concern has been raised that cheap imports are being dumped in the country, thereby killing domestic industry. The issue that arises is how we can liberalize the trade system in order to promote efficient use of resources without adversely affecting our efforts to promote local industry.

- It is becoming increasingly clear that structural reforms have to go beyond commitment to particular macroeconomic policy framework and systems of mobilizing and using resources to having institutions attuned to those reforms. In the process of reform we have not only emphasized the role of the private sector but also the significant reduction of the government presence in many spheres of economic activity. In my view, we have to go further and reform institutions to align them to a liberal economic environment. I have in mind the need to rationalize and have clear-cut responsibilities of government departments, including creation of a well-trained and effective civil service. There is urgent need to address the issue of work ethics within the civil service and in the country at large. There is need to promote professionalism and wider national and regional interest as a basis for accelerated economic development.

- The thorniest issue of adjustment is the social costs associated with such measures as elimination of subsidies and retrenchment in the public sector. How do we minimize these costs? This brings into focus such issues as the pace of implementation of the reforms and their sequencing. Should we go for a shock or gradual therapy type of reform strategy? Little research has been done to assess the impact of these reform strategies. Such knowledge is important as it would help the process of designing programmes that are more appropriate to our own situation.

Ladies and gentlemen, the need to diversify our economies in favour of increased share of manufacturing must be emphasized. However, our small domestic markets remain a major constraint. In this context, steps must be taken to encourage regional cooperation to create a wider market. For such actions to yield the desired results and for the sake of balanced trade, it is necessary that co-operating countries harmonize their fiscal, exchange rate and trade policies. This requires coordination of policy-oriented research and active involvement of senior policy makers. It also requires unwavering will and commitment by our political leaders.

Before I conclude, let me raise one additional issue that I consider important and feel that the participants should take time to discuss. There is urgent need for African researchers to reorient their research activities to focus more on economic problems facing our countries. They need to be more practical in providing alternative policy actions that are implementable. Their research reports, which form the basis of policy formulation, should be precise, unambiguous and simple. It is only in these ways that they can be useful for policy reorientation.

In conclusion, I wish to reiterate that I attach a lot of importance to this seminar. I am confident that at the end of the programme you will have greatly enhanced your understanding and appreciation of the issues I have raised and should be able to come up with practical policy recommendations to address them. I know the issues to be discussed are challenging and require that you take them seriously, given the urgent need to improve the performance of our economies. However, I would urge you to find time to tour the city of Nairobi and our countryside to see whatever progress we have made.

With these few remarks, ladies and gentlemen, I now declare this seminar officially open and wish you fruitful deliberations.

3.
Exchange Rate Policy

(non-CFA and CFA foreign exchange markets)

Authors and Presenters: C. Dordunoo, Ghana
A. M'Bet, Côte d'Ivoire

Summary of paper

Introduction

Until the mid-1980s, fixed exchange rates were seen by many African governments as desirable to ensure currency stability. However, more recently, most have realized the cost to competitiveness of fixed rates . They have moved to flexible exchange rates, first through administered systems such as step devaluations and crawling pegs, and in many cases through market-oriented systems such as foreign exchange auctions and interbank markets. At the same time, most governments have left foreign exchange allocation to the market, in order to generate more efficient resource allocation and use.

However, the shift away from fixed exchange rates is not the final step. It raises several fundamental questions about future policy – not least because a market-determined exchange rate is no longer a separate policy tool, but the outcome of external and domestic trends and policy measures. The key questions are:

- What should be the policy target? the nominal exchange rate, the real rate, or unifying parallel and official rates? depreciation to increase competitiveness or stability to reduce inflation?
- What are the causes and effects of changes in exchange rates?
- What are the most effective mechanisms for achieving the policy target? step devaluations or crawling pegs? auctions or interbank markets? rapid changes or gradual changes?

This paper draws on AERC and other research into the experiences of CFA and non-CFA countries to attempt to provide preliminary answers and to suggest areas where policy makers and researchers need to know more.

The exchange rate target

The main choice of target is between the nominal exchange rate (units of national currency per unit of foreign currency) and the real exchange rate (adjusted for relative inflation in national and international prices). Because the real exchange rate is the more accurate measure of international competitiveness, it should be the policy target. Of course, adjusting the real rate is almost certain to require changes in the nominal rate. The CFA countries suffered in the 1980s from trying to maintain competitive real rates by only internal adjustment measures. As a result, the inflation gains from a stable nominal rate were offset by output losses.

Most countries have started the adjustment process with highly overvalued exchange rates, and they have usually needed to devalue considerably to restore competitiveness. The ultimate goal should be a stable real rate, to minimize inflationary effects and maximize the credibility of government policy, which would enhance private sector supply response. Nevertheless, the specific target for stability remains unclear.

The other goal of recent exchange rate changes has been to unify the rates in the "official" markets and the "ex-parallel" bureau markets, by having one market-determined rate. This is not necessarily compatible with a stable real rate; if there are sudden or sustained large rises or falls in supply of foreign exchange to either the interbank or the bureau market, this may force the currency to appreciate or depreciate away from stability or undermine the unification of the two markets.

Causes of real exchange rate changes

Real exchange rates are influenced by two sets of factors:

- External shocks beyond the control of national decision makers. Research results indicate that the most significant negative shock is change in the terms of trade. Growth in trading partner countries, changes in foreign interest rates and capital inflows are also important in some countries.
- Other macro policies. Trade liberalization, a more open economy and higher absorption will depreciate the exchange rate. Tighter monetary and interest rate (and to a lesser extent fiscal) policies have the opposite effect. Inflation, GDP growth, exports and imports have mixed impact depending on the countries and time periods examined.

Effects of real exchange rate changes

The evidence on the effects of real exchange rate changes is mixed for most variables, and hard to separate from the wider effects of structural adjustment programmes. In the franc zone, it is generally too early to judge results with any clarity. Elsewhere, there has been a correlation between depreciation and capital inflows (aid and private), and between depreciation and export growth. The volume of imports has also risen sharply, resulting in wider trade and current account deficits. Exchange rate measures alone cannot elicit the desired balance of payments outcome. They need to be supplemented with compatible macroeconomic, export promotion and import rationalization policies.

Liberalized exchange rate regimes have usually coincided with GDP growth, but with varying effects on agricultural, industrial and service sectors. Particularly for agriculture, changes in the RER may be inadequate to increase production and exports. If Africa is to be competitive, complementary structural and institutional measures are needed to improve infrastructure, input supplies and market information for the real sectors, and to decrease their production costs. Even with all these measures, non-tariff barriers and overconcentration on a few commodities may undermine export earnings.

One crucial link between causes and impact is the effect of a nominal exchange rate depreciation on the real rate. Analysis shows that the trade-off between competitiveness and inflation is very real. Large devaluations may produce a sharp rise in inflation, though this may not be sufficient to prevent some real exchange rate depreciation. Gradual depreciations are likely to have less inflationary risk and therefore more real effect in the longer term. Monetary, fiscal and supply-enhancing measures are also needed to reduce the risk of inflation.

Mechanisms for change

The immediate problems here are different for CFA and non-CFA countries. In the CFA zone (if there is to be any more devaluation), the debate is over which flexible but administered exchange rate system to use. On balance, a crawling peg linked to the ECU or a wider basket would seem preferable to minimize inflation and maximize real depreciation. The second question is the role of a currency zone with nominal devaluation, which will exacerbate divergences between members' real rates due to the different terms of trade shocks, economic fundamentals and capacities to respond to devaluation.

Outside the franc zone, debate continues about the relative merits of different types of market-determined systems – mainly auction and interbank systems. Some evidence favours operating them as a sequence, with retail auctions followed by wholesale auctions and then interbank markets. However, it is clear that the success of these mechanisms has depended on gradual introduction, careful implementation, early large foreign exchange flows and compatible fiscal and monetary policies.

Research is clear that the foreign exchange bureaux introduced to legalize and monitor "parallel market" flows have been extremely positive. But, while foreign exchange markets have become more efficient (judged by their effects on the parallel market and capital flight) as a result of interbank and bureau markets, these markets remain segmented even in the most liberalized countries. In addition, in many countries the bureau markets are continuing to grow rapidly, contrary to expectations and intentions when they were introduced, while in others they have stabilized. Reasons for these differing trends remain unclear.

Issues for further research

Overall, the causes and effects of exchange rate changes have been well researched (except for the effects of devaluation in the franc zone). But the results remain sufficiently divergent that more study of detailed country-specific circumstances would be worthwhile, especially to monitor and explain short-term volatility in real exchange rates.

The key research issue must be when and how African governments should aim for a stable real rate. This will involve much more micro-level analysis of:

- The causes and effects of continued segmentation into official and "bureau" markets;
- The tension between the stable real exchange rate target and the unification of exchange rates; and
- The operation of the foreign exchange markets and participants.

The aim of such research would be to establish guidelines for constant micro analysis of the functioning of the foreign exchange, money and capital markets, to provide policy makers with an early warning system about trends in capital flows and other variables, so that they can gauge what should be the short-term aims of exchange rate policy.

CFA zone research needs to tackle the same issues, but will require slightly different frameworks, including:

- More analysis of the effects of the recent devaluation;
- The relative effects of crawling pegs and step devaluations; and
- The lessons of free-market exchange rates in non-CFA countries.

Overall, CFA and non-CFA countries face many of the same problems and should certainly study them together. We should take advantage of the regional network of AERC and the policy makers at this seminar to include a regional dimension in any project:

- How do competitive devaluations affect neighbouring countries, and (how) can exchange rate policies be harmonized to minimize economic disruption?
- What is the role of currency zones in harmonizing policies, and how will we achieve longer-term monetary integration across the continent or in sub-regions?

Comments and Discussion

Discussant 1: Dr. C. Kimei, Bank of Tanzania

Dr. Kimei commented that there is still no consensus on the ideal exchange rate regime or level, or above all on the objective(s) of exchange rate policy. Objectives are generally to improve the balance of payments and competitiveness through devaluation or to reduce inflation through stability (or both at different stages). These often conflict. In Tanzania, exchange rate liberalization and devaluation had improved the competitiveness of exports but did not reduce imports and therefore failed to improve the balance of payments. Inflation had not improved.

Second, he questioned whether it was possible to implement an objective by intervening in the foreign exchange market. Most African countries have insufficient foreign exchange reserves to combat external shocks (aid shortfalls or private capital inflows). In order to maintain a target, he suggested a crawling peg rather than a market rate for the CFA zone. In addition, the real exchange rate based on economic fundamentals is difficult to identify and therefore to target; a better guideline might be a stable nominal rate combined with low inflation. On the other hand, countries where competitiveness is the main aim might need to follow the example of the Asian Tigers and over-depreciate to get an export response.

Third, he suggested that unification of the official and parallel markets might not be the overriding objective. A small continuing differential between official and bureau rates is almost inevitable, due to different transaction costs and financial risks. He suggested the following areas for further research:

- The exchange rate regime that is most viable for different African countries, given their circumstances – crawling pegs, free floats, managed floats, currency boards, external anchors, etc.?
- The credibility of the exchange rate rule – how does the private sector respond to government signals on the desired exchange rate?
- Prospects and methods of harmonizing exchange rate and other macroeconomic policies in Africa (or sub-regions).

Discussant 2: Dr. I. Elbadawi, AERC

Dr. Elbadawi concentrated on the CFA zone. Though devaluation in 1994 had been essential, because domestic policy could not offset the negative effects of over-valuation, its successful transmission into increased competitiveness now depends on reducing labour costs, producing agricultural supply response and providing external debt relief. Devaluation is not a panacea; subsequent fiscal or monetary expansion would negate its effects, and accompanying structural measures are needed.

Monetary integration in the CFA zone remains highly positive because it coordinates macro policy, ensures convertibility and provides an external anchor. Though until the devaluation it had the disadvantage of removing the exchange rate as a policy instrument, this also appears to be partly true for the liberalized systems in non–CFA countries. There is therefore an urgent need for research on the implications of this loss of an instrument for monetary integration in Africa (especially because Africa is being marginalized by some international organizations and in the world economy). Finally, further research is needed on whether the CFA zone should move from the French franc to the ECU as an anchor – and whether an anchor might encourage excessive external dependence.

Discussant 3: Dr. F. Mwega, University of Nairobi

Dr. Mwega discussed the recent move to market regimes, based on the Kenyan experience. The key current issues are the desirable degree of convertibility (capital account or only current account), and the timing and methodology of expanding convertibility. Other concerns are the desirability and feasibility of intervention in the foreign exchange market and the trade-off between a stable rate as an anti-inflation anchor and depreciation to promote competitiveness. Finally the question is whether stability is more important than attaining a particular rate.

Each country needs to study these issues for itself and decide on its targets, objectives, intervention mechanisms and convertibility policy. This study would best be achieved by policy makers and researchers working together, dividing their labour in order to tackle immediate policy issues and longer–term economic fundamentals.

Discussion from the Floor

The discussion revolved around the feasibility of intervention in the foreign exchange markets and how to identify an appropriate rate. Some participants suggested that other macro variables (e.g., inflation) should be targeted instead of the exchange rate. They saw demand for forex as unclear, and supply of forex as distorted by large aid or private capital inflows (though some suggested that private capital inflows produced a realistic rate). In addition, the lack of timely accurate data on the determinants and effects of exchange rate changes make it harder to identify an appropriate real rate.

Others suggested that other policies could stabilize supply and especially demand, and therefore a broad target range is feasible with limited intervention. Any declared target must be adhered to in order to ensure policy credibility. While some proposed a return to crawling pegs, others indicated there might be intervention in markets to ensure a minimum of stability (without betting against the market). Overall, there was consensus that the question of intervention/targeting merits further urgent research.

On effects, some participants suggested that the current exchange rate volatility and depreciation affects investment and manufacturing negatively, and that import dependence is not falling as expected. Others said that these trends and negative effects will end once structural imbalances and external dependence are corrected; the exchange rate cannot fulfil multiple objectives on its own. Therefore, in the interim, other structural measures, not relying excessively on the exchange rate, should be implemented to enhance competitiveness with a special focus to promote small and medium enterprises that are less hit by import price rises due to devaluation.

CFA issues were discussed only briefly (due to limited CFA representation at the seminar). Some participants suggested that rumours of another CFA devaluation might be causing parallel markets to persist in CFA countries. They cautioned that external pegging was proving difficult even in Europe. There is need for continual reevaluation of the external anchor.

4.
Fiscal and Monetary Policy

Authors and Presenters: N. Osoro, Tanzania
N. Sowa, Ghana

Summary of Paper

Introduction

Since the mid–1980s, most African nations have been trying – with varying degrees of success – to reduce fiscal deficits and control monetary growth, reversing the excessive government spending and money supply expansion of earlier years. One major goal of these measures has been to reduce inflation.

This paper draws on empirical research commissioned by AERC, and other analysis of this set of policies. The purpose has been to extract the findings that are of most interest to African policy makers, and to identify the key policy areas that require further research to guide implementation. The further aim is to find areas on which policy makers and researchers can collaborate most effectively. The paper looks first at fiscal policy then at monetary policy and inflation.

Fiscal policy

The key issues in fiscal policy are fiscal structure (revenue, expenditure and deficits as a proportion of GDP) and macroeconomic effects of fiscal deficits. Other major concerns are relationships between revenue, expenditure and deficits; measures to cut expenditure and measures to increase revenue and reform tax administration.

Fiscal structure. African countries have not only been spending excessively, many have extremely low revenue to GDP ratios. However, counties divide broadly into those with high current expenditure to GDP and revenue to GDP (excluding grants) ratios, such as Malawi and Tanzania; and those with low expenditure/GDP and tax/GDP ratios, such as Ghana and Uganda. Different methods of measuring deficits, revenue (including grants) and expenditure (including capital expenditure) may give very different pictures. More research is needed to define the most appropriate measurements and sustainable targets.

Deficit effects. Apart from the negative effects on monetary growth, fiscal deficits can worsen external balance by increasing government imports. They may also raise interest rates by competing for domestic savings. Yet many governments have had little success in reducing the primary deficit (excluding grants and interest). Researchers and policy makers need to examine which methods of defict reduction are the most effective;

Relationships between revenue, expenditure and deficits. These have been extensively tested. There appears to be a one-way causation, with increases in revenue provoking offsetting increases in revenue. Deficit reduction therefore needs to stress expenditure cuts. Also, increases in deficits increase spending, especially when they are financed cheaply by borrowing because demand for public goods increases due to their lower tax price. More analysis is needed to disaggregate the expenditure and revenue variables and test their links in detail;.

Expenditure reduction. AERC research indicates that spending cuts need to be undertaken with care, because recurrent expenditure cuts are difficult to achieve and capital expenditure cuts can have a major negative impact on growth. Any capital expenditure cuts should be in unproductive defence and prestige areas. Again, more disaggregation is needed to see where cuts cause the minimum negative effects on GDP growth.

Revenue raising and tax administration. AERC has conducted extensive work on the design and effects of tax reform in Ghana, Malawi, Tanzania and Uganda. Tax reform has aimed to increase revenue, protect against imports, maintain equity, promote investment, simplify the tax system and improve tax administration. The major factor in more successful tax reforms (Ghana and Uganda) has been wholehearted improvement of tax administration, which has improved tax yield and revenue productivity far more than reducing rates. The less successful reforms (Malawi and Tanzania) have focused on increasing tax rates and introducing new taxes to broaden the base but have not improved administration.

Administration of expenditure. The desirable composition of expenditure cuts as outlined in planned budgets is often frustrated by political and administrative processes. These make social sector spending a "soft" target for cuts during budget implementation, and defense and domestic/external interest payments "hard" targets. Policy makers and researchers need to work together to identify optimal improvements in the administration of both tax and expenditure, particularly in the context of the current moves in many countries to decentralize both functions.

Monetary policy and inflation

The key issues here are the effectiveness of interest rates in monetary control and the relative roles of deficit financing/monetary growth and other factors in inflation. Also of great concern are the optimal level of inflation for tax seigniorage and government ability to control money supply through indirect monetary policy.

Interest rate effectiveness. Studies indicate that interest rates may be effective tools of monetary control. Except in Kenya, money demand in Africa has shown weak interest sensitivity, and investment has shown stronger sensitivity. However, these results may be partly the result of tracking negative real rates and other policies of financial repression, the thin financial markets, and inaccurate monetary data. More disaggregation and empirical analysis are needed.

Deficits, money and inflation. Deficit financing is strongly linked to monetary growth, as indicated by research on Ghana, Tanzania and Zimbabwe. Money supply is one major cause of inflation, through it has often been of secondary importance compared to shortage of goods or output. Governments should concentrate equally on policies to enhance supply, especially food production. Research has been very limited. on non-monetary components of inflation and effective policies to combat them .

Inflation and seigniorage. It is vital for all governments to identify the revenue-maximising rate of inflation in their country, in order to maximise tax revenue while controlling inflation. Empirical work in this area has covered only a few African countries, and needs to be extended to others.

Indirect monetary policy. Attempts to contain monetary growth through indirect monetary policy measures in a liberalized financial system, have met with minimal success. The effects of liberalizing interest rates and issuing government or central bank bills have been undermined by the thinness and undervelopment of financial markets. Distressed banking systems, the volatility of money demand and multipliers as well as elements of reserve money beyond central bank control compound the problem. Research on this area is at an early stage, and further work should be a priority.

Comments and Discussion

Discussant 1: Deputy Minister Selormey, Ministry of Finance, Ghana

Minister Selormey raised three fundamental problems:

- Dependence on volatile international trade taxes because low incomes reduce income tax. He stressed the need for research on indirect taxes, notably VAT, which had low collection costs and guidelines for monitoring and collecting such taxes for small and medium enterprises and self–employed people.

- How to reduce expenditure by limiting it to core government functions (social and economic infrastructure, defence and administration) and leave the rest (notably production) to the private sector. Cuts should in theory focus on recurrent expenditures, especially personal emoluments (by reducing the size of the civil service) and subsidies to parastatals. But higher incentives for remaining staff often offset cuts in staff numbers, and privatization is proving protracted in most countries. Capital expenditures are too low already in many countries, but are often the first to be cut due to external finance shortfalls.

- How to turn research findings and concepts in the paper such as the "optimal revenue–generating rate of inflation" and "interest rate sensitivity of money demand and investment" into operational policy ideas. The current findings are of questionable policy relevance.

Discussant 2: Mr. B. Fall, Ministry of Finance, Senegal

Mr. Fall referred to Senegal's generally successful tax reform, but reinforced the view that VAT is difficult to collect, especially from the informal sector, though Senegal had had some success. He stressed the need to consult the business community (and other target groups) before tax changes, to maximize revenue and transparency and reduce evasion. He also proposed more research into the longer–term sustainability of fiscal reforms and the identification of desirable levels of revenue and expenditure to GDP, based on the experiences of other (including non–African) countries.

He suggested that budget implementation is much more vital than budget design. Most analysis of budget policy is of the voted budget, but the amount and the composition of expenditure are often very different, and it is necessary to understand why. Finally, he saw a need for a study into how to achieve budgetary convergence among the UMOA countries to reinforce monetary and exchange rate complementarity.

Discussant 3: Dr. K. Oussou, University of Côte d'Ivoire

Dr. Oussou stressed the weight of external and internal debt service in expenditure. He asked for more research on the scope to cut this rather than other expenditure. Second, he emphasized the need to focus on revenue mobilization and widening the tax base particularly to the informal sector which might eventually provide up to 20% of revenue, and to land taxes and to crack down on tax evasion and fraud. Third, there is need for more work on how to reduce or eliminate the fiscal burden caused by loss–making public enterprises – and whether they could be made net contributors to the budget. Fourth, he suggested we should be looking at the quality rather than the quantity of expenditure. For example, cuts in recurrent expenditure may undermine the provision of remaining public services. Finally, he advocated a comparative study on the effect of the CFA zone's restrictions on printing money to finance budget deficits, and on whether there was room to soften the current fixed limits on CFA borrowing to finance deficits.

Discussion from the Floor

Several other revenue raising measures were suggested:

- Reducing corruption (smuggling/embezzlement);
- Cutting tax rates (though some doubted the efficacy of this); and
- Using personal tax identification numbers.

The importance of an autonomous revenue authority, with better remuneration of staff, was emphasized, though this was not a panacea. In this context, it is imperative that government demonstrate fairness and transparency in tax collection. Unfairness in poll taxes reduces collection in some countries.

- Pre–shipment inspection of imports; and
- Slashing officially authorized tax exemptions.

A number of expenditure measures were also proposed:

- Focusing cuts on defence, security and general administration;
- Concentrating expenditure on social sectors, human resource–building and poverty alleviation;
- Designing administrative reform in ways that would retain existing capacity and combat the brain drain; and
- Keeping down domestic debt and reducing external debt, to maximize scope for development–oriented expenditure.

The theme underlying the whole discussion was the need for research into the details of expenditure and revenue measures, rather than the overall aggregates. Other participants stressed research on the interactions between tax policy and other policies. For example, high corporate taxes should not offset export or investment incentives. They also asked for research on the desirable ratio of tax to GDP, which ranged in participating countries from under 10% to over 30%. Several questioned whether interest rates were effective instruments of monetary control in Africa; whether there was a "revenue–maximizing" inflation rate; and how/whether the findings of the paper should be used in setting target inflation levels, developing fiscal budgets or intervening on interest rates. Finally, there was wide agreement on the need for research on the budgetary process, particularly to identify why execution often bore little relation to intentions.

5. Financial Sector Policy

A: The Formal Financial Sector

Financial Sector Reform
Author and Presenter: A. Soyibo, Nigeria

Summary of Paper

Introduction

Financial sector reforms in Africa have led to an increase in the number and variety of financial institutions, as well as some improvement in macro aggregates such as the measure of financial deepening, M_2/GDP and the real interest rate. However, there has been no significant improvement in the maturity structure of deposit liabilities of financial institutions. Consequently, the problem of asset-liability mismatch persists in the system because the demand for investment funds, often long-term, has not diminished. This paper makes a case for the establishment of a long-standing forum of policy makers and researchers provide research support for policy making. The forum would be fed with policy research results aimed at improving policy design and implementation and would also help researchers to address research issues relevant to policy making.

The paper first examines elements of financial sector liberalization that formed the framework for evaluating financial sector reforms in Africa and then summarizes research results of AERC and other relevant networks evaluating financial liberalization in Africa. It considers policy issues or options emerging from the study and suggests an approach for establishing policy-research linkages.

Elements of financial sector liberalization

Financial programmes can be classified as either basic or comprehensive. The basic programme focuses mainly on the issue of positive response of savings (and economic growth) to interest rate. It is thus mainly concerned with dismantling credit and interest rate ceilings and the policy of directed credit. Comprehensive reform programmes are much broader in scope and have many varieties. At minimum, a comprehensive financial sector reform programme should put into place strengthened prudential regulations and improved bank supervision to mitigate adverse consequences of interest rate liberalization. It should also institute the policy of exchange rate reforms. Other elements of a comprehensive financial package are:

- Explicit consideration for the health of the real sector
- Strengthening the legislative framework for bank operations
- Ensuring safety of deposits
- Management of non-performing assets
- Review of the capital structure of financial institutions
- Development of the human capital of the Financial system
- Change in ownership of financial institutions
- External liberalization and financial openness
- Enhancement of the information base for the financial system

Analysis of financial sector reforms in Africa

Most African countries embarked on comprehensive financial sector reforms without taking the financial health of the real sector into consideration. This has varied implications for sequencing and speed of implementation of reform. On the other hand, African countries seem to have avoided the pitfalls of Latin American countries as regards adopting policies of external liberalization and financial openness.

- Other conclusions that can be drawn from a content analysis of financial sector reforms in Africa are:
- Most African countries implemented reforms involving the policy of exchange rate adjustment.
- Strengthening of prudential regulations is yet to be done in some countries involved in financial reforms.
- Deposit insurance is not yet in vogue in Africa.
- Not enough attention has been paid to the development of the information and human capital of the financial system.
- Changes in ownership of financial institutions seem to be easier in nationalized financial systems.
- Only a few countries gave explicit consideration to sequencing issues and speed of implementation of reforms.

Policy issues

Policy credibility and consistency are critical in the success of any economic reform package macroeconomic stability, which is important to the stability and efficiency of the financial system. Financial reform policies, moreover, must recognize the dual role of the interest rate both as a return on and a cost of investment. Further, the development of information and human capital within the financial system should be given top priority to ensure the success of reforms.

Bank-centred development strategy needs to be strengthened by promoting ownership of equity in firms by institutional investors. There is no need for an inflexible and doctrinaire transplant of the market-centred development strategy of the capital market in Britain and America. However policy issues related to the creation of agencies to manage non-performing loans are important in the design and implementation of financial reforms.

Finally, the paper points out that the role of government as regulator and player in the financial system often leads to conflict of interest.

Policy-research link and other issues

It is important to establish a framework for assuring that the results of policy research are fed into the policy-making process. This will sharpen the focus and relevance of the research and improve the viability of the policies. Two research foci come to mind: subregional and continental. Some of the themes or topics that such a link can address include:

- The incidence and macroeconomic impact of financial distress in Africa.
- The social cost of comprehensive financial reforms on the poor and other vulnerable groups.
- Design and optimal sequencing of financial sector reforms in Africa.
- Evolution of financial reforms, their successes, pitfalls and lessons.

Comments and Discussion

Discussant: Governor Yansané, Central Bank of Guinea

Governor Yansané commented that the paper was pessimistic in its assessment of the outcomes of financial sector reforms. Reform should be seen as a long process, given the previous poor state of the sector. Guinea has closed many of its banks abruptly, managed credit tightly and introduced new regulations, deposit protection and bank management structures. These irreversible measures, he said, decisively demonstrated government credibility and reduced inflation. Though credit remains short–term and investment is low, lack of finance is only one constraint on the private sector. It is often less important than the lack of business and financial training of entrepreneurs.

He agreed with the sequencing discussed in the paper – inflation control, bank restructuring, stable interest rates, elimination of the parallel market and then indirect monetary policy. He also agreed that banks are unable or unwilling to provide finance to rural areas due to problems with collateral and loan recovery, and high administration costs. He proposed that governments and donors cooperate in creating separate community based rural finance systems and in research on these issues.

Discussion from the Floor

The discussion centred on the treatment of distressed banks. Some suggested that banks currently have little incentive to collect loans, because they feel they will be "bailed out" by government or donors. They therefore tend towards "adverse selection" (investment in riskier areas). Strong views were expressed against deposit insurance (which might create "moral hazard" among lenders and borrowers and encourage "fictitious" deposits) and against abrupt bank closures (because of disruption confidence in the financial system). Non–performing assets agencies were generally felt to have been very positive, particularly in the transparency of their collection procedures, and preferable to ad hoc bank restructuring. There is no "optimum" number of banks in a country, but competition is critical, and effective regulation and on–site supervision are vital preconditions of "free entry and exit". In view of the discussion, a priority for additional research was felt to be further study of how bank distress has been overcome in CFA and non–CFA countries.

There was some discussion of whether central banks should be independent of finance ministries, to enable them to perform their regulatory function. Views differed, with some suggesting that reporting to the presidency was worse and consultation between finance ministries and central bank was preferable. The issue deserves further examination.

There was strong agreement that in most countries the current design of financial sector reform is not providing sufficient finance for the productive sectors (especially small and medium enterprises). Other measures suggested to reinforce financial sector reform were strengthening the legal system, especially bankruptcy law and reducing bank intermediation costs by improving communications infrastructure and cutting labour costs. It was also thought necessary to assure flexibility in introducing new financial sector regulations to avoid negative effects on intermediation and to encourage national social insurance funds. Rural community or "people's" banks need to be established. Above all, it was felt that each country had something to teach others, and that more study is urgently needed.

B: The Informal Financial Sector

Informal Sector Finance
Author: E. Aryeetey, Ghana
Presenter: A. Soyibo, Nigeria

Summary of Paper

Introduction

Few African countries are without informal financial activities. Various studies carried out by AERC researchers have identified a number of different informal financial 'institutions'. These include savings and credit associations (SCA) rural savings and credit cooperatives and professional moneylenders. Part-time moneylenders, such as estate owners, traders, grain millers, small holder farmers, employers, relations and friends are all important sources of informal finance. In West Africa, *susu* collectors, mobile bankers, money guards are also common, as are urban credit unions.

Most of these may be found in both urban and rural areas. The prevalence of one institution or the other varies across countries. Recent researches provide great insight into their functioning as they begin to establish the sizes of informal financial sectors in a number of countries and trends in links with formal financial institutions. The analyses of operations, performance and impacts of informal units in economies undergoing structural adjustment are of great interest for their policy implications.

One of the most important outcomes of these analyses has been to establish the structure of informal financial markets in Africa. The markets are deeply segmented and transactions in one segment hardly ever affect transactions in others. The large number of operating units the variety of types and the minimal interaction among them, makes us describe the markets as fragmented. This high level of fragmentation and the limited information about the various segments for economic analysis have often made considerations of informal finance in policy matters intractable.

The research shows that informal finance, is, in many countries, is as large as formal finance, and in some probably larger. It is especially interesting that, in the period following the liberalization of many economies, informal finance has grown faster than formal finance, which contradicts the accepted notion that informal finance was due to repressive policies. Informal finance will do well in any growing economy in which formal finance fails to reach specific niches in the market.

Regulation should be designed so as to encourage or provide an incentive for the expansion of informal units into semi-formal lending units, and incentives for banks to channel credit through such semi-formal units. Governments need to abandon a passive attitude to mainstream informal finance and accelerate its transformation and growth by reducing market distortions and overcoming institutional inadequacies.

Governments require a more "proactive approach", including a legal, regulatory and prudential framework to foster and accelerate financial market development. Such a framework would encompass the mechanisms, institutions and instruments to promote and facilitate market development as the economy grows and market functions expand. Regulation should avoid restrictive law and focus on removing obstacles. Restrictions on the types of assets banks may hold could be modified to encourage investment in semi-formal financial institutions. This requires the diversification of formal sector instruments.

Unfortunately, in many countries informal finance has not had the desired impact on production due to the nature of informal financial products. They do not satisfy the requirements of potential entrepreneurial borrowers. For many expanding micro businesses, informal loans often have too short a maturity period, excessive interest rates, and insufficient loan amounts.

Integration with formal sector

Experience shows that economic growth which propels increasing informal activity can modifiy in the ways in which lenders structure their businesses. As they expand, they try to link more closely with the banking system: This could, in principle, open up the financial systems in many countries. Policy makers need to encourage a closer interaction between the formal and informal sectors. Where this has happened, as in parts of West Africa, semi-formal institutions have emerged, which lend themselves readily to regulation and supervision by the appropriate authorities.

The result is modern companies, registered and visible in their operations. This is an essential requirement for them to reach a large number of customers and gain access to the banking facilities. This link to the banking system ensures that the usual tools for regulating money supply affect their operations and the way banks relate to them. Being major deposit mobilizers, they have a role to play in controlling the supply of money that would otherwise remain outside the banking system.

Regulating the informal sector

It is our view that policy makers need not expend resources on regulating and supervising informal financial units. Any attempt to do so would force them underground. Indeed most African administrative structures possess little knowledge of informal institutions and are therefore ill-equipped to monitor and regulate the large number of such organizations. Administrators have often, therefore, been tempted to apply repressive instruments to coerce an informal sector response. The best time to introduce regulation is when informal lending units have expanded, in response to demand, into semi-formal units that can no longer be efficiently kept out of the public eye.

Comments and Discussion

Discussant: Deputy Governor Odozi, Central Bank of Nigeria

Deputy Governor Odozi commented that many governments used to see the informal sector as a response to "financial repression", but evidence now indicates that it also has a valuable role to play in filling gaps in a liberalized system. Semi–formal institutions such as people's banks and other community savings schemes provide valuable intermediation and links to the formal sector as well as a potential channel for formal–informal integration. On the other hand, finance houses do nothing to mobilize savings.

However, governments and donors are only beginning to design a policy framework for the informal financial sector; this is a rich area for further research. They still have many barriers to overcome: the prejudice of associating informal with "black" markets; the lack of constantly–maintained and comprehensive data on the informal sector" and a dynamic framework to analyse how to integrate the formal and informal sectors.

He called for positive policy measures to encourage informal and semi–formal institutions while strengthening prudential regulation and supervision, as opposed to the current passive policy stance in most countries. The balance between encouragement and regulation would vary by institution – for example, pyramid schemes would be tightly regulated or discouraged.

Finally, he suggested areas for further research:

- Semi–formal institutions (function, regulation, links with formal);
- Systematic data collection on these institutions; and
- How policy makers and researchers could cooperate in this area.

Discussion from the Floor

Francophone policy makers indicated that the description of the anglophone informal financial sector in the paper also applied largely to francophone countries, where it is usually more widespread. The main institutions are *tontines,*, which have low default rates (in contrast to donor credit lines or cooperatives) and important intermediation functions, but which largely finance consumption.

Some additional informal financing mechanisms were highlighted. A credit in kind through goods (for example from wholesalers to retailers) finances a large proportion of informal sector trade. Much finance comes from nationals of African countries who live overseas and want to repatriate some of their foreign exchange earnings informally. Current research work could be extended to cover these institutions.

Many participants provided explanations for the persistence of the informal sector after liberalization:

- *The exclusion of certain groups (women, the poor, rural dwellers, ethnic minorities) from the formal system.* Research was suggested on how formal or semi–formal institutions could reach these groups.

- *Complex procedures to access funds supplied by the formal sector and many donors.* Participants also suggested that donors might have a role to play in financing informal institutions in order to reach the poor. One country cited the example of French financial support for a comprehensive network of mutual credit unions in the rural areas. Another cited the increasingly positive attitude of the Bretton Woods institutions to these issues.

- *Socio–cultural factors.* These encourage informal community groupings and keep default rates low in contrast to the ineffectiveness of formal sector guarantees and collateral which would undermine any attempts to formalize these institutions.

Regulation was seen as very complex. Non–bank financial institution laws are usually very tough but not enforced/enforceable for informal institutions. Though some countries are revising them to apply to the informal sector, this is difficult because the institutions take so many different forms. Self–regulation might be better, letting institutions fail and encouraging clients to monitor them rather than relying on the central bank. Positive examples of combining regulation and semi–formalization with encouragement were mentioned, notably the Grameen Bank in Bangladesh. Much more investigation is needed, especially of examples from inside and outside Africa where informal or semi–formal institutions have financed micro–enterprise investment.

6. The Overall Macro Agenda: Interactions and Sequencing

Authors: M. Martin, External Finance for Africa
L. Kasekende, Uganda
Presenter: L. Kasekende, Uganda

Summary of paper

Introduction

This paper examines the overall macroeconomic policy research agenda. It goes beyond the individual policy sets, discussed in earlier sessions, in two ways. It examines research on the formulation and implementation of overall economic programmes (particularly their sequencing, consistency and credibility). And it draws attention to other neglected policy areas which are crucial to long-term development.

In the last ten years, most African countries have adopted structural adjustment programmes to correct imbalances in their economies. Many countries have made significant progress with stabilization, and the paper describes the positive results in Uganda. However, removing earlier distortions has revealed new problems and challenges, due to weak and unstable markets and limited administrative capacity.

Gaps in research

Little of the existing research has analysed the formulation of overall policy programmes. There are few studies of sequencing, consistency or credibility in the context of differing national characteristics and initial conditions (such as level of development and adaptability to change, policy making and administrative capacity, ownership, political economy, information flows).

The literature on sequencing (except in a few over-studied areas) is frequently confusing, or suggests simultaneous "advances on all fronts". This has led policy makers to design programmes on the basis of political or administrative capacity or negotiating pressures. Most African countries have therefore departed from the few elements of consensus in the literature and focused excessively on stabilization and liberalization rather than broader "structural" adjustment policies.

Research has highlighted the pursuit of incompatible or inconsistent policies as a major danger to the sustainability of adjustment programmes. However, the paper shows how even "compatible" stabilization policies can unexpectedly prove incompatible in a liberalized environment. This has forced unwelcome choices among macroeoconomic targets, or trade-offs among policy objectives. One example is the recent "Uganda Disease" of exchange rate appreciation, which potentially creates sustainability problems for the overall programme.

Research vs Reality

The role of the state, when mentioned in macroeconomic research, is often confined to implementing credible stabilization and liberalization policies. Debates continue over whether credibility is enhanced by "big bang" or "gradualist" reform, or by preannouncement or "lock-ins" of policy change. Policy makers have found that the reality is more subtle. Credibility is extremely hard to establish due to poor information and data, market imperfections and perverse incentives for the private sector. There are also many "grey areas", where neither African nor developed-world policy makers have certain policy remedies. Excessively rapid transitions to free markets can exacerbate these problems and undermine policy sustainability – notably by reducing availability of information. However, beyond certain core functions, the role of a more active, market-friendly state in Africa remains unclear.

Research and Policy Rrecommendations

Based on these findings, the paper contains a rich list of recommendations for future research cooperation between policy makers and researchers and reinforces the recommendations of earlier sessions to deepen our research into existing "core" AERC areas:

- Promotion of savings and investment, especially in private sector and financial sector deepening.
- Detailed implementation of stabilization; for example, policies to combat the structural (as well as the monetary) causes of inflation, mobilize budget revenue and change the composition of expenditure.
- Detailed design of trade liberalization, including tariff reform in the context of inadequate customs services, and export promotion links.

The paper also urges a widening of the agenda to focus on the real economy and on the key "enabling factors" in longer-term development:

- Public enterprise reform and private sector promotion;
- Administrative, capacity-building and labour market reforms;
- Policies to combat unemployment and underemployment, to maximize training and human capital formation;
- Policies to promote technological progress, industrialization, agricultural revival and physical infrastructure developments; and
- The huge field of sustainable human development: education, health, gender, population, income distribution, the environment.

The following research questions about macro programme formulation are posed:

- What is a desirable and sustainable ultimate degree of stabilization (fiscal, monetary, exchange rate)? Are the ultimate targets a particular level of price or surplus, or a relative degree of stability?
- What is the desirable and sustainable sequencing of adjustment. In particular, how do we accelerate implementation of structural, "real economy" and "human development" policies?
- Given the trade-offs among "compatible" policies, what is the relative importance of different "price" and real economy targets?
- What is the desirable role of the state, and how can governments best promote credibility and an enabling environment?
- What are the key long-term objectives of economic policy (narrowly-defined growth or broader sustainable human development) and the key enabling conditions for achieving these (technological progress, financial deepening, industrialization, agricultural revival, domestic savings and investment, physical infrastructure, human capital formation)? How do current macroeconomic targets enhance these?
- What are the macroeconomic policy implications of different sources of external financing (different aid types, various private capital flows)? How can we maximize the absorption and productivity of these flows, and ultimately reduce dependence on them by enhancing savings?

Finally the paper suggests avenues of cross-country cooperation between policy makers and researchers:

- Joint research projects, in which researchers could provide literature surveys and comparative analysis of non-African experience and a longer-term outlook, freed from the "fire-fighting" by policy makers;
- Issue-specific workshops on current policy issues (indirect monetary policy, private capital flows) for which researchers could prepare background papers and act as resource persons;

- Joint compilation of more accurate and detailed data, to which researchers could contribute by surveying private sector and informal sector motives, responses to policies, information needs; and
- A permanent network for exchanging information among policy makers and researchers and for facilitating joint research projects, issue-specific workshops and inter-African capacity building.

Comments and Discussion

Discussant 1: Professor B. Ndulu, AERC

Professor Ndulu's comments focused on two issues, going beyond stabilization: the transition from controlled to market regimes, and the consistency between short-term macro and long-term development policies. The new macroeconomic consensus of reform appears to be that:

- inflation is worse than unemployment, implying forceful inflation control via monetary policy, and more tolerance of unemployment.
- growth depends largely on supply–side incentive and liberalization policies rather than effective demand.
- monetary policies affect prices but not production.
- fiscal deficits crowd out private investment, and fiscal restraint therefore cuts inflation and frees funds for the private sector.

However, many countries are having problems with this consensus due to the shallowness and imperfections of their markets. Among the major problems and areas for further research are how to increase savings and investment by mobilizing domestic resources and their links to aid dependence, macro and civil instability, internal and external debt, and monetary policy need investigation. Translating resources into growth through focus on investment productivity, infrastructure and human capital development is also critical.

He noted that macro policy effectiveness depends heavily on credibility and consistency in financial sector reform and market liberalisation, as well as microeconomic responses to macroeconomic policies.

Further study is also needed into mechanisms for coping with external shocks – excesses or shortfalls of capital, different motives of private capital (investment or speculation), and the monetary and exchange rate policy response. In addition, trade–offs and sequencing of reforms, particularly the tension between growth/employment and inflation control, are critical areas in need of investigation.

Discussant 2: Mme. D. Mané, Ministry of Finance, Senegal

Mme. Mane focused on the credibility of macroeconomic policy and the role of government. She argued that more research is needed on the conflicts and lack of credibility caused by the different demands of interest groups within countries – and by the international institutions and donors. These conflicts lead often to inconsistency through abrupt changes of policy. It is not surprising that private sector actors then respond – quite rationally – to this inconsistency and lack of credibility by decreasing investment.

In order to overcome these problems, governments need time to develop a clear vision of their short– and longer–term aims, which the demands of internal and external negotiations often prevent. They would not sacrifice the long–term for the short–term, an all too common situation given the need for immediate measures. This vision might be easier to develop if governments adopted a genuinely "bottom–up" approach to designing longer–term development policy by consulting their people systematically. More research is needed on how programmes are currently designed and how they can be adapted to a bottom–up, long–term approach.

Discussion from the Floor

The discussion highlighted that most countries had taken insufficient account of sequencing, credibility and consistency in designing their macroeconomic programmes. There was agreement that this reflects the pressure of negotiations, cross–conditionality and the lack of sufficient technical staff with the capacity to adapt the "macro consensus" to African countries' conditions. However, one participant warned that these are highly political issues, which are not always amenable to technical solutions. Another suggested that in his country, "shock treatment" and irreversible measures (rather than gradualism) have worked well, though some inconsistencies remain.

There was general agreement that the role of government in the liberalized system and government's interactions with the private sector are priorities for further research. Most agreed that governments have little long–term vision, and that even some core government economic agencies lack ownership of current short–term programmes. Bottom–up development and national ownership of the programmes was felt to imply not just multi-party democracy but decentralization and involvement of local NGOs in policy discussions, to get beyond interest groups. Governments also need to analyse potential costs and benefits of all policies – especially to civil servants responsible for their execution – and to consult potential winners and losers before implementation.

Other key factors in the transition from stabilization to growth were identified: the quality of fiscal reforms (i.e. types of expenditure and revenue measures rather than global aggregates), which influences foreign capital flows; the upgrading of administrative capacity and retention of existing capacity in order to design longer–term programmes; debt relief to remove the debt overhang as a disincentive to investment; and the creation of an enabling environment for the private sector (economic, social, administrative, legal and infrastructure). There was debate over which type of external shock is worse: insufficient capital inflow or too much capital inflow.

Other ideas suggested for further research were export diversification, import rationalization (though a project had just been completed on this by six African governments) and measures to accelerate the overall supply response as well as savings and investment.

7.
The Policy Process

Author and Presenter: J. Hoffman, AERC

Summary of Paper

Introduction

AERC is widely regarded as having developed a network of African economists. But to what extent, are these economists (or their research output) utilized in the economic policy development processes of African governments? This paper presents the findings of two "policy" studies looking at the relationship between research and policy in Ghana, Uganda, Tanzania, Zambia, Senegal, Cameroon and Côte d'Ivoire.

It considers the features of formal and informal economic policy decision making and the extent to which policy makers draw upon African economic research and the related professional skills in each country. Perceptions of the linkage or absence of linkage between economic research and policy decision making are reported.

The policy-making process

Significant common factors and differences in policy-making processes across countries were found, including:

- The creation of super-ministries, typically combining finance and national development planning, and a decline in the role of national planning commissions as an instrument of economic policy in most countries.

- Varied use of presidential commissions or consultative bodies to develop consensus on economic policy. In many countries, inclusion of universities or university-based economists has at best been marginal. Although new policy/research centres are emerging in all countries, a wider range of national policy/research organizations appears active in the francophone countries. However, economics societies at the national level are completely absent in the francophone countries visited. Francophone economists do not appear to have the same shared sense of an "economics profession" as do their anglophone counterparts.

- A declining role for national central banks in non-core functions such as sectoral policy or regional development, and increased Bank attention to financial system regulatory issues. BEAC and BCEAO interact with local researchers in a markedly different than national central banks in some anglophone countries. For example, collaborative research between BEAC and BCEAO staff and external researchers is rare.

- Instability in universities, which affects the output and capacity of researchers and influences the way senior government officials look at university-based researchers. The academic and institutional "culture" in francophone countries is seen as more rigid and specialized; the absence of formal collaboration across institutional boundaries is largely attributed to the "culture" of the francophone academic environment. Universities are seen as "ivory towers" and have generally weak ties to government and business.

- An unprecedented level of interest in economic research following the recent CFA franc devaluation. Economic journalists are perceived as more professional in CFA franc countries.

General perceptions and suggestions on AERC's role

Most persons interviewed felt that AERC's primary goal should be the development of researchers, its secondary goal should be strengthening research-policy linkages. Many ideas and suggestions were offered, such as:

- Broadening opportunities for researchers to provide input and have dialogue with policy-makers at the national and regional levels;
- The development of various communication tools for better linkage of researchers and policy makers;
- Ways to encourage participation by new researchers in the AERC network, as well as modifications to AERC's process which might enhance attention to the policy relevance of research; and
- The need for graduate training and professional development to place the research process in context with the policy process and develop skills useful in policy dialogue.

Recommendations

The synthesis report provides several recommendations taking into account AERC's financial and human resource limitations and the need to be realistic about the capacity of a pan-African organization to change what is essentially local interaction between policy-makers and researchers. Despite these constraints, AERC is well situated to bring researchers and policy makers closer together. To some extent, its success can be measured in the long-term improvement in the economics profession and the policymaking capacity of governments. The report recommends that AERC incorporate specific measures into its planning process to enhance the link between research and policy making. Recommendations are offered in three distinct areas:

1) **An outreach strategy to increase awareness of AERC among policy-makers and potential researchers.** Recommendations include:

    - Countries where the objective would be to support efforts of local AERC researchers to connect with local policy makers
    - Countries where the objective would be to identify and locate new researchers and key policy makers to make them aware of AERC.
    - "Market testing" among a sample group of senior policy makers could be used to design the outreach strategy.
    - A different form of publication may be required for francophone Africa.

2) **An interaction strategy to increase the frequency and quality of dialogue between researchers and policy makers.** Recommendations include:

    - Ideas on how AERC should continue to support national policy workshops;
    - A more concentrated effort to facilitate research-policy dialogue at the regional and sub-regional levels; and
    - An exploration of how future policy seminars might be structured.

3) **An education/training strategy for researchers**. The idea is to give researchers a better understanding of policy processes and the tools and approaches useful in adding value to policy development. Recommendations include:

    - Ways to provide more guidance and feedback to researchers during the review of papers and to increase the degree of policy-related discussion and feedback during research workshops.
    - A review of graduate training programmes to assess whether current curricula could do more to develop economists capable of contributing to policy development.
    - Information gathering about the economics profession and the activities and specialistions of researchers and potential researchers in Africa. This could include a comprehensive data base fed automatically during registration of participants in any AERC-supported activity.

Comments and Discussion

The discussion was short of time, but focused on issues in four areas: the cleavage between policy makers and researchers, the roles of policy makers and researchers, mechanisms to encourage dialogue, and the role of AERC.

Cleavage between policy makers and researchers

Problems are both political and practical. Previous repressive political regimes, obsessed with confidentiality, often prevented access to information or involvement by researchers. Even in open regimes, policy makers tend to require quick answers to precise policy questions and commission research in a demand–driven way. Researchers however tend to write historical analysis in long, complex projects, which do not promote a supply–driven policy process. The problem is exacerbated by the very different service terms and conditions in the civil service and universities. Any personnel movement tends to be one–way (to civil service), and universities have few staff with government experience.

There is moreover, suspicion between policy makers and researchers because the former tend to avoid theory and believe researchers have little practical to contribute. The latter are too academic and believe policy makers will not listen.
This is perhaps more pronounced in the francophone system due to the highly theoretical training received in francophone universities

However, in many countries the barriers are breaking down and cooperation is improving, especially due to training in non–African countries where interaction among policy makers and researchers is more common.

The desirable role for researchers and policy makers

While researchers should be encouraged to become more policy–oriented, especially in making their research more user–friendly to policy makers and in working on joint research with policy makers, they should not become policy advisers.

Mechanisms to encourage dialogue and interchange

Among the suggestions made were more active involvement of academic researchers in policy research through joint research projects with policy makers and more participation in and research support to national planning commissions and longer–term development issues. Local sabbaticals would allow policy makers and researchers to move temporarily into each other's sphere. It was also felt vital to involve the wider community in the dialogue — especially the private sector, economic journalists and the general public.

The role of AERC

AERC should continue to facilitate dialogue between the two groups, as in the current seminar. Input into future seminars should continue to distil academic research to make it usable by policy makers, and the output should be to encourage policy–oriented research. However, after this introductory broad seminar, future seminars should focus on specific issues (even some of those covered at this seminar) and preferably specific research projects, to allow time for indepth exchange of experiences.

8. Working Group Conclusions

The aims of the working groups were to identify and prioritize major policy research issues and to identify mechanisms for pursuing the dialogue begun at the seminar. There were four working groups: francophone, anglophone west, anglophone east and anglophone south. Their conclusions are presented in aggregate form: while the precise wordings of working group findings were slightly different, they were surprisingly similar in the research issues and potential follow–up mechanisms they identified.

Research Priorities

Exchange Rate Policy

All groups saw a need for more research on the role of exchange rate policy in a liberalized economy with a more flexible exchange rate regime. Topics identified included.

- The feasibility/desirability/aim/nature/scope of intervention in the foreign exchange market;
- How to determine the appropriate real exchange rate and short–run target range in conditions of distortionary external capital flows; and
- Defining the objective of policy (competitiveness or lower inflation).

Such research should take into account the role of other policies influencing competitiveness, include a comprehensive assessment of different exchange rate regimes, and examine the desirability of indexing to an external anchor.

The francophone group stressed the need to examine CFA and non–CFA countries together in order to learn mutual lessons from semi–fixed and market regimes. It was also necessary to explore conditions for harmonizing CFA/non–CFA rates and policies, and for subregional/regional currencies and economic integration.

Fiscal and Monetary Policy

On the fiscal side, there was a need to go beyond previous broad research into fiscal aggregates and to look at precise revenue and expenditure measures, the budget process and long–term fiscal sustainability. Key issues were:

- How to design and especially implement domestically–driven expenditure programmes, and to identify expenditure priorities for long–term growth;
- How to increase revenue and expand the tax base, especially how or whether to tax the informal sector; and
- Long–term sustainability (and desirable levels of revenue and expenditure compared to GDP), as well as the reduction of internal and external debt and of dependence on external aid.

On the monetary side, three groups expressed interest in studying the preconditions, transition mechanisms, objectives, targets (reserve money, interest rates) and effective methods of indirect monetary control. The anglophone south group also wanted to look at prospects for monetary integration.

Financial Sector

The issues focused on how to mobilize finance for production, especially:

- Financial sector distress: how to clean up commercial banks and sequence this with financial sector liberalization, in a way that encourages the financing of production;
- The role of new financial market mechanisms and financial deepening;
- How to finance the rural sector, building on successful experiences;
- How to overcome market failures and information asymmetry, and their implications for the design and sequencing of liberalization;
- Whether to/how to establish central bank independence; and
- Informal sector: country–specific studies of the size and characteristics of the sector; how to fill the gap between the formal and informal sectors, especially in financing SMEs and investment, possibly with semi–formal institutions.

Overall Macroeconomic Programmes

The top priority research area here was the role of goverment in the liberalized economy. This involved the sub–issues of credibility in policy making and private sector response/ expectations, administrative capacity, ownership by the wider society, and bottom–up development programming.

The second most important issue – top priority for some countries but unimportant to others – was the management of macroeconomic policy in the context of external shocks, especially excessive or insufficient capital inflows. This would involve analysis of the sources/nature/purposes of private and aid–based capital inflows, the risks of exchange rate appreciation or depreciation, reserves accumulation or depletion, monetary sterilization and absorptive capacity issues.

Third, there was support from three groups for more study of the regional dimensions of adjustment, particularly removing trade barriers, monetary integration and exchange rate integration.

Sequencing and sustainability issues were raised by all groups, but in different forms: "long–term sustainability", "growth–inflation–unemployment tradeoffs" and "sectoral sequencing". Proposals for research in the specific subject areas (especially the financial sector) were also made.

Other issues raised by individual groups included the determinants of foreign investment (investment codes/deregulation or wider macro/capital flow factors), privatization, private sector promotion and the optimal size of government.

Follow-up mechanisms

The top priority identified by three groups (one did not really discuss mechanisms) was joint research projects between policy makers and academics at a cross–country level, coordinated by AERC, with clear division of labour among policy makers and researchers to complement each other.

The francophone group felt strongly that francophone policy makers had been under–represented at the seminar, and suggested a special follow–up meeting with francophone policy makers (possibly co–hosted by the BCEAO). The lusophone member of this group also suggested that AERC should do more to inform lusophone countries about, and involve them in, its research.

Other ideas emerging were:

- A regional network of seminar participants, with a named contact point in each country, to pursue follow-up;
- A directory of polic-oriented (and other) researchers in Africa listing specialization and experience of policy;
- Issue-specific follow-up seminars, and urgent dissemination of the results of the seminar, especially to donors;
- More national policy workshops;
- Involvement of wider groups – business, religious, media, NGOs; and
- Expansion of AERC dissemination activities.

9. Summary of Participant Evaluations

As is normal in AERC workshops, participants were asked to evaluate the seminar in writing, using a predesigned form. A sample form is attached to this report as Annex C. Overall, the evaluation was extremely positive: one member of a working group suggested that policy makers were left "panting for more". Another said it had been an "eye–opener" for policy makers about AERC and the potential for cooperation among policy makers and researchers.

In answer to specific questions:

- Every participant found the seminar worthwhile, in almost all cases due to the policy maker/researcher interaction and the exchange of experiences with other policy makers.

- All would attend another seminar. Though their priorities for topics varied, around half wanted a seminar on the financial sector, on fiscal and monetary policy or on relative roles of government and private sector. Other popular subjects were regional integration and trade promotion, overall macro–micro policies and links, and exchange rates.

- All but one participant found the seminar a useful way to share ideas and experiences with counterparts from other countries, especially on indirect monetary policy, exchange rate policy and financial sector. (The exception was a francophone/lusophone policy maker who complained about the poor quality of interpretation into French).

- All suggested they would be more likely to use AERC researchers and research materials in future policy–relevant research.

- All but one suggested that the research presented had added to their knowledge of policy issues, especially through the informal financial sector and overall macro agenda papers (and secondarily the financial sector reform, fiscal and monetary and exchange rate papers), and by allowing them to share experiences and gather empirical evidence.

- All but one found that the seminar had provoked ideas for future interaction among policy makers and researchers in their own countries, including joint research, seminars, staff exchanges, cooperation in "policy units" or working groups, production and dissemination of executive summaries, and collecting data.

The questionnaire asked whether enough time was allocated to the various sessions. In general, the duration of sessions was felt to be about right, particularly on the exchange rate. However, a quarter of participants felt more time was needed for fiscal and monetary policy, financial policy and the overall macro agenda; a third for the research process; and half for the working groups. Only one policy maker said a session (the financial sector) had been too long. Some also commented at the end of the evaluation form that the working groups were too short and that too many subjects had been covered. While there was an understanding that this seminar needed to cover a wide range of subjects in order to show AERC's expertise, many requested that future seminars focus in depth on individual session topics or sub–topics.

Participants assessed in general the quality of written presentations, oral presentations and executive summaries. The written presentations ranked very highly; the oral presentations and the executive summaries slightly lower. However, corridor conversations indicated some confusion as to whether "executive summaries" meant those of the seminar papers, or those of AERC research papers that were also prepared for and distributed at the seminar.

In ranking the relative worth of individual papers, there was also confusion as to whether 1 meant high or low. However, inverting the order of the rankings to conform with each participant's answers to questions about which papers were most useful and informative, produces the same result as excluding the confused responses. As a result, it it clear that the sessions rated most highly were those on the overall macro agenda, the exchange rate and the financial sector. These results also fit with the negative assessment of the working groups because they were allowed insufficient time.

Around 80% of participants favoured each of the specific suggestions for follow–up made in the questionnaire: putting them on AERC's mailing list, inviting them to another policy seminar, encouraging joint policy research projects between researchers and policy makers, encouraging national policy workshops and establishing a mechanism for constant exchange of information between policy makers and researchers. Other suggestions included establishing a national "contact point" in each country to promote involvement in cross–country policy research projects; reinforcing AERC's translation service to provide more output in French and Portuguese; widening the participation to more countries — or to larger groups of staff from a smaller number of countries; linking more closely with policy units and planning commissions; and establishing a permanent communication network structure among the participants and other policy makers and policy–oriented researchers.

On key future research issues, the top priorities were exchange rate policy (10), expanding fiscal revenue (9) and overcoming financial sector distress (8). Other prominent issues were the role of government in a liberalized economy (6), macroeconomic sequencing (5), indirect monetary targets and policy (4), how to finance SMEs innovatively (4), investment and savings (3), private sector promotion and privatization (3), capital flows and external shocks (2) and informal finance (2). Also raised were data quality, capital markets, regional integration, export diversification, labour markets, the future of the CFA zone, and debt.

On the seminar arrangements, at least three–quarters of the participants rated the timing of the invitation, the travel arrangements, the accommodations and the venue as excellent, and the other quarter rated them good. Four participants were disappointed with the content of the invitation, rating it "adequate" or "fair", due to a feeling that it had not adequately described the richness of the seminar. Half the participants rated the structure of the seminar as only "good" due to time shortages is discussed above.

10. Conclusions and Recommendations

This summarizes the overall findings of the seminar, and suggests ways in which AERC might respond. Its framework has been set by the proceedings and conclusions of the seminar, especially the working groups and the participant evaluations. It is also based on several discussions with AERC senior staff (especially Professor Ndulu and Dr. Elbadawi), and on the summary by Dr. Elbadawi of AERC's response in his reply to the working group presentations in the closing session of the seminar (In his response he stressed AERC's existing mechanisms for encouraging policy maker–researcher cooperation and the need to look beyond Africa and avoid policy advocacy.)

The seminar fully achieved all of its aims, as specified in Part 1. As shown in particular by the participants' answers to the seminar evaluation questionnaire, it improved prospects for policy involvement by interested AERC researchers, increased AERC visibility in the policy making community, identified possible areas of policy research for AERC–funded researchers to consider and provided an opportunity for policy makers and researchers to exchange experiences and views. In addition, participants produced many ideas for additional mechanisms to increase AERC visibility and coordination of policy research in Africa. This concluding section therefore has the task only of choosing and refining the best ideas of the seminar participants, and matching them with what it is feasible for AERC to achieve.

Research Agenda

There is no doubt that the seminar achieved the aim of widening and deepening the policy research agenda. Each of the sessions on policy areas produced at least one coherent set of issues that could be researched, according to the discussion in the sessions, the conclusions of the working groups and the priorities of the evaluations. In turn, these were:

- The role of exchange rate policy in a liberalized economy, especially the scope for intervention in forex markets;
- The process of budget formulation and execution, especially on new sources of revenue mobilization;

- The implementation of indirect monetary policy;
- How to encourage investment in production (especially medium, small and micro enterprises) through enhanced financial sector reform, better–designed measures to overcome bank distress and the encouragement of informal financial markets;
- The role and credibility of government; and
- Macroeconomic responses to external shocks in the form of excess or insufficient external capital flow.

The issue is how to study these topics. Some of them are already being covered by existing projects – notably the second, through AERC's budget process study and the last, through a SIDA - funded project on the macroeconomic implications of capital flows. The seminar has already had a valuable input into the design of both of these projects, and into identifying policy maker participants. The particular lessons for the content of the projects were:

- The need to focus on revenue as much as expenditure, and on budget implementation as much as design, in the budget study; and
- The need to balance countries with excess capital flow and those with insufficient flows, in the capital flow study. In addition, it might be possible to enhance cooperation between ESAIDARM and AERC by involving AERC researchers in the capital flows–reserves study. AERC should initiate contacts with ESAIDARM to this end.

Four projects remain, of which three (exchange rate, indirect monetary policy and investment in production) fit into existing AERC thematic areas. It is strongly recommended that AERC take the lead in sponsoring three cross–country comparative research projects in these areas, to be conducted by country teams of policy makers and researchers from selected countries.

These projects would need to be carefully structured to ensure clear and productive division of labour among researchers and policy makers. For example, researchers could contribute surveys of literature and of non–African experiences, theoretical background papers, econometric modelling, and sample surveys of the private sector. Policy makers could identify key issues in each country to ensure policy relevance, and analyse government data, institutional capacities and current policy thinking.

In order to finalize the design of such projects and to pursue the follow–up of the seminar, it is recommended that AERC hold a meeting of a Policy Research Working Group, inviting six participants from the seminar (i.e., one policy maker and one researcher interested in each of the project areas), as soon as possible. These participants would take responsibility for advising AERC on general follow–up and for pursuing the formation of project teams and the finalization of research project design.

The fourth project – the role and credibility of government – does not appear to fit into

AERC's immediate research agenda. Instead, *it is recommended that AERC raise this issue in other fora* more interested in political economy issues – for example, the Global Coalition for Africa – and suggest cooperation between political economy and economic analysts in a study of these issues covering African and non-African countries.

Many other topics and sub-topics were suggested which would be best pursued by sub-groups of countries or by individual groups of policy makers and researchers, or by being fed into any future design of projects in these issue areas by AERC researchers, to make them more policy-relevant. Therefore dissemination of the seminar report, as well as ongoing AERC research reports to the widest possible policy makers and researchers is desirable.

Other Follow-up Mechanisms

The seminar was an extremely successful mechanism for disseminating knowledge of AERC's aims, procedures and products to policy makers. In terms of product, both the seminar papers and the executive summaries of other papers were very well received. Several of the policy makers had virtually no knowledge of AERC products, and 80% asked to be put on AERC's mailing list.

However, the seminar itself was small (for purposes of fruitful discussion) and reached relatively few policy makers. The question is how to disseminate the seminar results and future AERC products to a wide network of policy makers. It is suggested that AERC:

- *Produce three written outputs from the seminar itself*: a very brief summary of seminar highlights; more detailed report on the seminar; and a full volume of proceedings including the text of the papers presented. Each will reach different audiences: the first will be useful for senior policy makers; the second for seminar participants, research–oriented policy makers and AERC researchers; and the third for all those interested in the details of policy–oriented research areas.
- *Create a directory of researchers in its network who are interested in policy research* (or, for other purposes, a directory of all member researchers and their research interests, highlighting those who are interested in policy issues), and circulate it to African research institutions and governments.

In future, AERC should make every effort to widen the group of enthusiastic policy makers created by the seminar into a permanent network of Africans interested in policy research. *Each of the policy maker and/or researcher participants in the seminar might be requested to act as a "contact point" for AERC in their country, with regard to future policy research.* Known interested policy makers and researchers in countries which did not participate might also be contacted, and asked to serve as contact points.

These contact points, as well as the other participants should be asked to name other research–oriented policy makers in their country, particularly those in planning commissions and policy units.

The seminar report, copies of the executive summaries of AERC research reports and other future relevant AERC outputs, should then be distributed as widely as possible, either directly or through named contact points.

AERC should ensure that more of its researcher members are informed of the results of the seminar, in order to involve them in follow-up projects. It might consider devoting a plenary day to presentation of the papers and discussions at the senior policy seminar (or perhaps a half–day presentation of this report).

There should be more national policy workshops, and AERC should highlight the conclusions of this policy seminar (and the existence of and follow–up policy research projects) in future workshops.

AERC should reinforce links with francophone policy makers, as recommended by the francophone working group. Contacts should be made (with advice from existing AERC researchers, policy-maker participants in the seminar and advisory committee members) with BCEAO and BEAC, in order to organize a presentation of the results of the senior policy seminar at one or both of these institutions, and to discuss cooperation on policy-oriented research (especially given the findings that almost all issues were similar for CFA and non-CFA countries).

Lusophone policy makers and researchers are particularly poorly served by research networks, and both of the lusophone participants in the seminar expressed willingness to act as national contact points for AERC. Comparative cross-country research projects may provide a unique opportunity to involve these countries in AERC work. In addition, AERC might consider exploring further research cooperation with the lusophone African countries as a whole, through well-funded mechanisms created by the European Union and Portugal.

Finally, there are lessons for future seminars, above all from the time shortage in the meeting. As described above, all of the participants expressed the strong hope that AERC would organize similar seminars in future, but that they should focus more closely on individual issues. Given that the issues suggested virtually coincide with the proposals for policy research projects, it would seem most productive to organize follow-up seminars in line with the progress of the research projects. Each of the three research projects outlined above could begin with a small seminar to discuss the project issues in more detail. Other policy makers and researchers, expert in the project issues, could be invited to attend in order to provide input on project design.

At later stages, other policy makers could be invited to meetings of the project teams in order to comment on findings. Obviously, there will remain a need to present new thematic areas (especially trade policy) to the policy making community as AERC develops a body of polic-relevant research in these areas. However, such presentations should be made in 12-18 months (with a maximum of two issues for discussion), when work is already well advanced on the agenda produced by the current seminar and lessons are available on the progress of policy research projects.

ANNEX A: Programme

Senior Policy Seminar
30-31 March, 1995
Serena Hotel, Nairobi

Day 1, Thursday 30 March 1995

9:00	Opening:	T. Kibua, Deputy Governor, Central Bank of Kenya Benno Ndulu, Executive Director, AERC	
9:30-12:30	**Theme I:**	**Exchange Rate Policy (non-CFA and CFA, Foreign Exchange Markets)**	
	Chair:	**Andrew Mullei, Director, ICEG**	
9:30-10:30		Presentation:	C. Dordunoo, Ghana A. M'Bet, Côte d'Ivoire
		Discussants:	C. Kimei, Tanzania I. Elbadawi, AERC F. Mwega, Kenya
10:30-11:00	Coffee/tea		
11:00-12:30		Discussion:	Exchange Rate Policy
12:30-2:00		Lunch	
2:00-4:30	**Theme II:**	**Fiscal and Monetary Policy**	
	Chair:	K. Yansané, Governor, Central Bank of Guinea	
2:00-3:00		Presentation:	N. Osoro, Tanzania N. Sowa, Ghana
		Discussants:	V. Selormey, Ghana B. Fall, Senegal K. Oussou, Côte d'Ivoire
3:00-4:30		Discussion:	Inflation, Monetary and Fiscal Policy
4:30-5:00		Coffee/tea	

5:00-6:00	**Theme III:**	**Financial Sector Policy (part 1)**	
	Chair:	V. Selormey, Vice Minister of Finance, Ghana	
5:00-5:30		The Formal Financial Sector	
		Presentation:	A. Soyibo, Nigeria
		Discussant:	K. Yansané, Guinea
5:30-6:30		Discussion	

Day 2, Friday, 31 March 1995

8:30-10:00	**Theme III:**	**Financial Sector Policy (part 2)**	
	Chair:	V. Odozi, Deputy Governor, Central Bank of Nigeria	
8:30-9:00		Informal Sector Finance	
		Author:	E. Aryeetey, Ghana
		Presentation:	A. Soyibo, Nigeria
		Discussant:	V. Odozi, Nigeria
9:00-10:00			Discussion
10:00-10:30		Coffee/tea	
10:30-12:00	**Theme IV:**	**The Overall Macro Agenda: Interactions and Sequencing**	
	Chair:	T. Owusu, Deputy Governor, Bank of Ghana	
10:30-11:15		Authors:	M. Martin, U.K. and L. Kasekende, Uganda
		Presentation:	L. Kasekende
		Discussants:	Benno Ndulu, AERC D. Mané, Senegal
11:15-12:00		Discussion	
12:00-1:30	**Theme V:**	**The Policy Research Process**	
	Chair:	D. Mulaisho, former Governor, Bank of Zambia	
12:00-12:45		Presentation:	J. Hoffman, AERC
		Discussants:	J. Doriye, Tanzania
12:45-1:30		Discussion	
1:30-2:30		Lunch	

2:30-4:15		**Working Groups to Prepare Conclusions**
2:30-2:45		Outcome of seminar and framework for working groups Presentation: M. Martin, U.K.
2:45-4:15		Working Groups
4:15-5:00		Coffee/tea
5:00-5:45	**Closing Session** **Chair: Ibrahim Elbadawi, AERC**	
		Conclusions: Working group leaders
5:45-6:15		**Closing Remarks**

ANNEX B: Participant List

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ANNEX C: Questionnaire

QUESTIONNAIRE TO EVALUATE

THE AERC 1995 SENIOR POLICY SEMINAR

1. Did you think that attending the AERC Senior Policy Seminar was a worthwhile experience? Yes/No
   In what way?

2. Would you attend another one, on different policy topics? Yes/No
   Which topics?

3. Was enough time devoted to each topic?

		Not enough	Just right	Too much
I.	Exchange rates			
II.	Fiscal/monetary			
III.	Financial sector			
IV.	Macro agenda			
V.	Policy/research			
VI.	Working Groups			

4. Did you think that the AERC research results were effectively synthesized and presented?

		Very effective	Satisfactory	Ineffective
I.	Written papers			
II.	Oral presentations			
III.	Executive summaries			

5. What, in your view, were the most useful sessions? Please rank them in order of preference (1 low - 6 high).

I. Exchange rates
II. Fiscal/monetary
III. Financial sector
IV. Macro agenda
V. Policy/research
VI. Working Groups

6. Did you find the seminar a useful opportunity to share ideas and experiences with your policy-maker counterparts from other countries?
   Yes/No
   In what way?

7. Following the seminar, would you be more less (circle one) likely to involve AERC researchers in policy analysis?

8. Following the seminar, would you be more/less (circle one) likely to ensure that you or your staff regularly review AERC materials?

9. Did the research presented add to your knowledge or understanding of the policy issue? Yes/No

10. Which paper added most to your knowledge?

11. Did the seminar provide you with ideas as to how researchers and policy-makers could interact more effectively in your country in the future?
yes/No
Examples:

12. How would you like AERC to follow up on this seminar?

I. Put you on the mailing list for AERC publications
II. Invite you to another
III. Encourage researchers and policy makers in your country to work together on policy research projects.
IV. Encourage national policy workshops in your country
V. Facilitate an ongoing exchange of information between policy makers and researchers
VI. Other

13. What would you suggest are the three most important areas of policy-related research in the near term?

14. How would you rate the conference arrangements:

		Excellent	Good	Adequate	Fair
I.	Invitation (timing)				
II.	Invitation (information)				
III.	Travel arrangements				
IV.	Accommodation				
V.	Seminar venue				
VI.	Seminar structure				

Do you have any other comments.

Name: Country:

AFRICAN ECONOMIC RESEARCH CONSORTIUM (AERC)

The principal objective of the African Economic Research Consortium (AERC), established in 1988, is to strengthen local capacity for conducting independent, rigorous inquiry into problems pertinent to the management of economies in sub-Saharan Africa. In response to special needs of the region, AERC has adopted a flexible approach to improve the technical skills of local researchers, allow for regional determination of research priorities, strengthen national institutions concerned with economic policy research, and facilitate closer ties between researchers and policy makers. AERC is supported by private foundations, bilateral aid agencies and international organizations. Further information concerning the AERC and its publications can be obtained by writing to:

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