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Exiting the cycle of conflict in South Sudan

Diversifying trade for sustained and inclusive prosperity

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Abstract

The violence in South Sudan in 2013 punctured the euphoria surrounding the ending of 21 years of conflict (1983–2005) and the emergence of South Sudan as an independent nation in 2011. The economic factors contributing to the political instability have been apparent since independence, yet they have not been addressed with any urgency. On the one hand, the traditional sources of livelihoods such as farming and cattle-rearing remain devastated. On the other, the flooding of the economy with revenue from oil exports has skewed incentives towards capturing rents. Falling oil reserves, as well as price volatility, are adversely affecting South Sudan's economy. Arresting the deteriorating situation will require investing oil revenues and aid resources in building capacity to diversify production and trade

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Table of contents

Acknowledgements ii

Abbreviations ii

1 Introduction 1

2 Trade profile 2

3 Weak productive capacity 6

4 Outlook for trade diversification 9

5 Conclusion 11

References 12

Figures

Figure 1: South Sudan: trade balance 2
Figure 2: Declining oil revenue in South Sudan 4

Tables

Table 1: South Sudan: major export destinations and import sources, 2013 3
Table 2: Dominance of the oil sector in the South Sudan economy 3
Table 3: 2013/14 approved budget, provisional outturn and 2014/15 budget 6

Abbreviations

AGOA	African Growth and Opportunity Act
DFQF	Duty-Free, Quota-Free (market access)
DTIS	Diagnostic Trade Integration Study
EAC	East African Community
EBA	'Everything but Arms' (EU preferences for Least Developed Countries)
EU	European Union
GDP	Gross Domestic Product
LDC	Least Developed Country
SMEs	Small- and Medium-Sized Enterprises
SSP	South Sudanese Pound
US	United States
WTO	World Trade Organization

1 Introduction

South Sudan became independent in 2011, marking the end of one of the longest conflicts in recent sub-Saharan African history and ushering in hopes of a more peaceful and prosperous future for its citizens. However, this optimism was punctured by the onset of internal conflict in December 2013. Since then the country has faced a worsening humanitarian crisis, and there are concerns that it could enter a vicious cycle of increasing instability, politically and economically (Deng et al., 2014).

The skewed productive structure of South Sudan's economy is at the root of the country's instability. Oil exports dominate the economy and government revenue. They generate large revenues (about US$20 billion from 2005 to 2014, equivalent to 98% of the annual government budget), but weak governance has meant that these have not been used to invest in building productive capacity. Slight changes in oil production, prices and demand quickly translate into massive economic shocks.

Reliance on a single commodity has created inertia against institutional reform, and the political incentives of the nascent state are being shaped by capturing the gains from oil exports. At the other end of the production spectrum are people living at subsistence level. Between the two, the middle ground is virtually empty. The key challenge that remains unaddressed is filling this void by building productive capacity and diversifying production and trade.

The failure so far to resolve outstanding post-independence political issues such as the status of Abyei (and therefore border demarcation) have meant that building productive capacity and diversifying trade are yet to be given high priority, and remain side-lined by both government and donors. The current priority being given to nation building, with the issues of trade and productive capacity to be addressed at a later date, is counter-productive as the two are inherently linked.

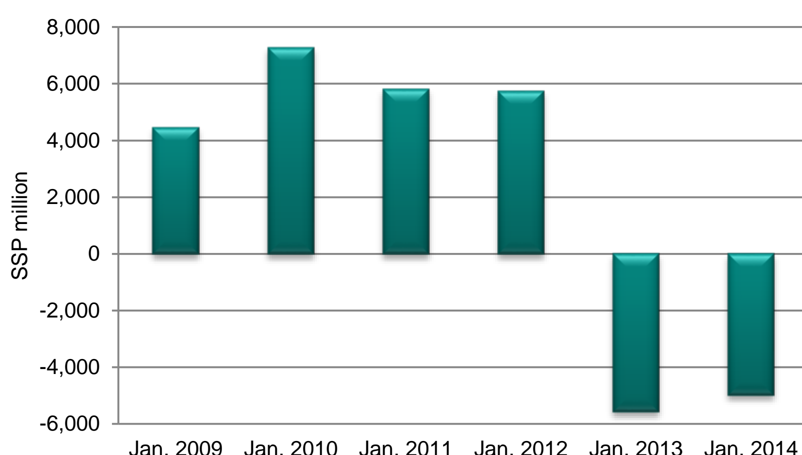
We argue that unless South Sudan's economy is transformed it is difficult to imagine the emergence of long-term peace and shared prosperity. Investing now in productive capacity would allow South Sudan to create a broad and inclusive economy. Trade (if effectively leveraged) will provide access to capital (investment), technology, and know-how. This paper discusses the importance of trade and production diversification, and the challenges South Sudan faces in achieving this. The paper concludes by arguing that investing in building productive capacity will be critical if South Sudan is to embark on sustained and inclusive prosperity.

The rest of the paper is structured as follows. Section 2 provides an overview of South Sudan's trade profile. Section 3 discusses constraints to raising productive capacity and provides possible policy and structural objectives. Section 4 examines the outlook for trade diversification. Section 5 concludes the paper with suggestions for immediate policy priority.

2 Trade profile

South Sudan has a narrow trade basket that is heavily dependent on a single export commodity – mineral fuel – which makes the country's economy vulnerable to shocks from changes in production, global demand and world prices. Other potential export items, not currently exploited, include gum arabic, fish, timber, and gold (see Government of the Republic of South Sudan, 2014). The country's trade surplus is largely a result of its oil exports, and increased from South Sudanese Pounds (SSP) 11.8 billion (equivalent to US$3.99 million if evaluated at the official exchange rate of SSP 2.96/$1) in 2009 to SSP 20.5 billion (about US$6.93 million) in 2012, reflecting the increase in oil exports. However, since 2013 South Sudan imports have been greater than exports resulting in trade deficit (see Figure 1).

Figure 1: South Sudan: trade balance



Source: http://www.tradingeconomics.com/south-sudan/balance-of-trade.

There are no national data on exports and imports. The National Bureau of Statistics used mirror data in developing their trade profile.[1] According to mirror statistics from the United Nations International Commodity Trade (COMTRADE) database,[2] China, Pakistan, Costa Rica, Uganda, the US and the Netherlands were the top destinations for South Sudan's exports in 2013 (see Table 1). On the import side, the top sources were Pakistan, Uganda, China, the US, France and Germany. The biggest import items from China were electrical machinery and vehicles, and from Pakistan sugar, confectionary and rice.[3] According to the National Bureau of Statistics, building materials were the largest specified import item (accounting for about 9%

[1] Discussion with the Directorate of Statistics Department on 8 January 2015. The National Bureau of Statistics use mirror data from IMF, Uganda Revenue Authority and Uganda Bureau of Statistics.
[2] South Sudan has not yet reported any trade data to the UN's COMTRADE database. Mirror statistics (i.e. data reported by South Sudan's trade partners) can only be indicative, and must be treated with caution, not least because several other countries (particularly in sub-Saharan Africa) do not report their data, and many of those that do report have not necessarily yet done so for the most recent years.
[3] The information was further validated through discussion with traders in Juba's largest market, Konyokonyo, in January 2015.

of the total import value), followed by petroleum products (8%), cooking oil (6%) and medicine (4%).[4]

Table 1: South Sudan: major export destinations and import sources, 2013

Exports		Imports	
Destination	*Value 2013 (1000 US$)*	*Source*	*Value 2013 (1000 US$)*
China	2,468,344	Pakistan	82,595
Pakistan	5,710	Uganda	80,305
Costa Rica	818	China	75,087
Uganda	230	US	22,206
US	210	France	17,329
Netherlands	63	Germany	16,497

Source: Mirror statistics from the United Nations COMTRADE database, April 2015. Please see footnote 2 regarding mirror statistics.

Oil production and exports accounted for 60% of gross domestic product (GDP) in 2011 (Ministry of Finance and Economic Planning, 2014). The drop in oil prices in 2008–9, following the global financial crisis, led to a dramatic contraction in public revenues[5]. According to the national Development Plan (2011–13), the government was unable to meet its spending commitments, including salaries, state transfers and investments in social service delivery. And in 2012 the contribution of oil export revenue to national budget reduced to 78% due to the shutdown of oil production owing to political differences with Khartoum over transit fees.

Table 2: Dominance of the oil sector in the South Sudan economy

	2009	2010	2011	2012
Non-oil exports (% of total exports)	3	3	2	22
Oil exports (% of total exports)	97	97	98	78

Source: Ministry of Finance and Economic Planning (2014).

Oil exports accounted for about 98% of the total value of exports in 2011 (Table 2). It is also a large source of government budget revenue (Basnett and Howell, 2012) and, despite falling global oil prices, are likely to remain high in the medium term until other economic sectors develop. But given the destruction of oil infrastructures and lack of competence in rebuilding them, less will be coming from the oil sector to meet national expenditure plans. At the same time, given the lack of policy focus on

[4] These figures were provided on 26 August 2014. The vast majority of imports (67% of the total value) were classified as 'other'.

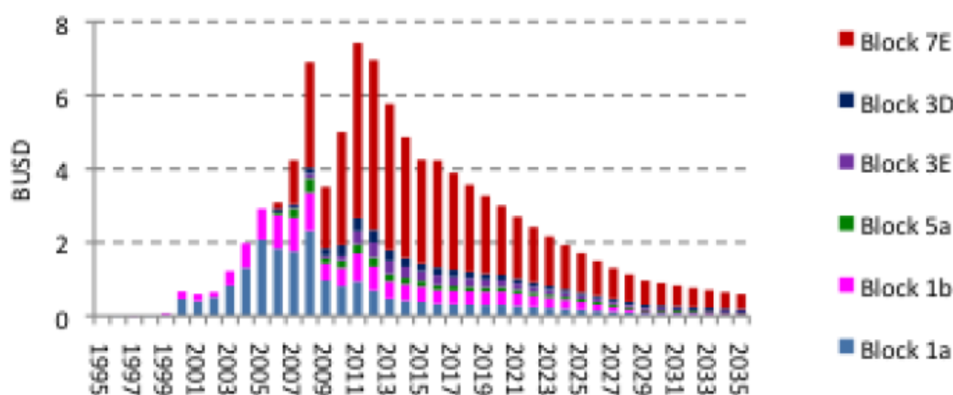
[5] The Petroleum Act and the Petroleum Revenue Management Act are two critical pieces of legislation which, if implemented properly, could increase transparency and reduce the misuse of oil revenue.

building productive capacity it is likely to be many years before non-oil economic sectors emerge to fill the same gap.

The current low global oil prices are beginning to hurt national income and government revenue. The poor quality of South Sudan's oil means that it receives low prices relative to other suppliers.[6] South Sudan received more than US$100 per barrel until 2015, but this has fallen to below US$50 during 2015. The country is also locked into a fixed-rate agreement with Sudan for the use of Sudan's oil pipeline (at a rate of US$10 per barrel), plus compensation to Sudan for loss of oil revenue after independence (US$15 per barrel) (IMF, 2014). The two in combination account for about half the current oil price and therefore place a fiscal squeeze on South Sudan, with the International Monetary Fund predicting that the fiscal deficit could rise to over 12% of GDP in 2015.

There is also further concern that oil production may have already peaked, in 2009 (at 362,000 barrels per day). While production in 2011 was forecast to be 357,000 barrels per day, this was expected to fall to 197,000 barrels per day in 2016, and to only 55,000 barrels per day in 2025.[7] Consequently, the revenue from oil exports is expected to reduce substantially over the coming years (Figure 2).

Figure 2: Declining oil revenue in South Sudan



Source: Government of the Republic of South Sudan (2011).

South Sudan's total oil wealth is estimated at US$38 billion, which is based on estimated future revenues from existing oil fields. Total oil revenues from blocks located in South Sudan were expected to be US$7.4 billion in 2011, falling to US$4.2 billion in 2016 and eventually disappearing. Given the rate at which oil revenues are likely to decline, it will be extremely difficult to build up non-oil revenues quickly enough to offset this. Even if non-oil revenues were to grow at a rate of 15% per year, which is unlikely given the current fall in global oil prices, total revenues are predicted to fall significantly over the next twenty years.[8]

Subsistence agriculture remains the dominant sector for household livelihoods. About 78% of the households in South Sudan derive their livelihood from agriculture. There are few alternative sources of employment as the formal sectors are yet to develop. The National Household Survey of 2009 found that more than

[6] http://www.ft.com/cms/s/0/6ba9f528-869c-11e4-8a51-00144feabdc0.html?siteedition=uk#axzz3MdSsqBle
[7] There exist varying estimates for when production will fall to this level, with some suggesting 2035 and others 2020 (Basnett and Howell, 2012).
[8] Government of the Republic of South Sudan (2011).

50% of the population is underemployed, and that only 12% is in formal employment.

Goods ranging from construction materials to food items such as onions have to be imported from neighbouring countries, mostly Sudan, Uganda and Kenya. For example, South Sudan's 'Diagnostic Trade Integration Study' (DTIS) (Government of the Republic of South Sudan, 2014) found that basic grains and flour, sugar, vegetables and fruit, as well as some fish, sold in markets such as Juba and Yei are typically imported from Uganda and Kenya.

Fertile land and rich pastures give South Sudan a natural resource that would permit competitive production of crops and livestock. However, conflict has devastated production and severed traditional trading relations. Despite this, communities in Northern Bahr el Ghazal have managed relations with groups in Sudan of the same ethnicity to permit trade to flourish on the border (Garang, 2014a). The DTIS identifies the following potential export products: livestock, forest products, and crops.

3 Weak productive capacity

Non-oil revenue represents a small share of the total budget (Table 3). The provisional outturn figures for the first six months of fiscal year 2013/14 indicate that government revenue collections are likely to differ widely from both the budget approved for 2013/14 and that estimated for 2014/15, creating fiscal uncertainty. This is because the revenue base is narrow and depends on sources that are unstable. For example, the budget approved for 2013/14 estimated collection from customs to be SSP 359 million (US$121.3 million), but as at December 2013 the provisional outturn was only SSP 55 million (US$18.6 million). This large discrepancy has huge implications for budget execution.

Table 3: 2013/14 approved budget, provisional outturn and 2014/15 budget

Source	2013/14 approved budget	2013/14 provisional outturns to December	2014/15
Total resources available	10,403	3,485	11,279
Net oil revenue	6,972	3,424	8,899
Non-oil revenue	1,967	423	2,654
Personal Income Tax	*301*	*112*	*332*
Sales Tax/Value-Added Tax	*657*	*90*	*975*
Excise	*240*	*61*	*359*
Business Profit Tax	*113*	*55*	*209*
Customs	*359*	*55*	*116*
Other revenue (fees, licences, etc.)	*297*	*50*	*663*

Source: Ministry of Finance and Economic Planning (2014). Financial Year 2014/2015

About 99% of all firms in South Sudan are classified as small and medium-sized enterprises – SMEs.[9] For example, a recent field assessment in the state of Northern Bahr el Ghazal found that 97% of the firms sampled were micro or small enterprises, and 3% medium; none was classified as large (Garang, 2014a).

[9] According to the World Bank classification, a firm is considered a microenterprise if it employees one to four persons, as small if it employs five to nineteen, as medium if it employs 20 to 99, and as large if it employees 100 or more.

Producers in South Sudan face many constraints, including lack of infrastructure, finance and poor governance (Basnett, 2010). Any support that removes or reduces demand and supply barriers is welcome. This includes simplifying document requirements, training of SMEs in best business practices, and resolving issues of land title deeds. The financing of SMEs in South Sudan could be enhanced through embracing a financial inclusion agenda, strengthening the current weak institutional regulatory framework and channelling parts of the oil revenue to the economy through the banking sector (Garang, 2014b). More specifically, policies should support the establishment of reference bureaux, encourage banks to lend to productive sectors as well as expansion of financial services beyond Juba (the capital city). Building private sector capacity will be essential for the functioning of local markets and for trade diversification.

The business environment in South Sudan is unfavourable to trade. One problem is the issue of tax multiplicity at legal checkpoints and extortion at illegal roadblocks,[10] which adds extra costs to transport. Lack of competition, weak enforcement of laws and absence of appropriate regulations mean that importers are easily able to pass on the cost of multiple taxes to consumers in the form of higher prices. Moreover, tax exemption regulations are often abused and tilted toward the ‘big’ men in South Sudan. Favouritism of this kind tends to undermine governance.

High transport costs reduce trade flows. For example, a trader who imports goods from Uganda all the way through Northern Bahr el Ghazal State to Gok Machar in Aweil North County incurs high and extra costs of car repairs (the poor roads lead to excessive tyre wear and other damage), fuel (multiple checkpoints mean vehicles have to stop and start) and delays *en route*. And, of course, an already bad situation gets still worse during the rainy season, when roads are frequently impassable for days.

South Sudan ranks third-lowest in ease of trading in the world (just above Afghanistan and Central African Republic) when it comes to trading across borders. Trade infrastructure in South Sudan remains weak. On average it takes entrepreneurs in South Sudan 12 documents, 130 days, and US$9,285 to import a standard container of goods, and ten documents, 55 days and US$5,335 to export one.[11] In 2011, there were 44 authorised and 65 unauthorised tax collection institutions operating throughout the country.[12]

In spite of the availability of a deep-water port in Port Sudan, Sudan, the continued violence along the Sudan–South Sudan border has severed this historical trade route. Mombasa has emerged as the alternative, but transportation of goods from Mombasa to Juba entails two national border crossings – between Kenya and Uganda (at Malaba) and between Uganda and South Sudan (at Nimule). This has inevitably added to the cost of transporting goods in and out of South Sudan.

The prevalence of a parallel market exchange rate to the official one has inhibited trade and reduced investments. At independence, the official exchange rate was pegged as SSP 2.96 to the US dollar, while the parallel market rate has fluctuated between SSP 4.5 and about SSP 7 since then. An overvalued exchange rate damages trade competitiveness, as it makes South Sudanese exports relatively expensive.

Furthermore, the volatility in oil prices means that the government finds it very difficult to manage its official fixed exchange rate. In 2013 parliament refused to

[10] During his keynote address to the Second Annual Economic Policy, the Hon. Finance Minister Agrey Tisa Sabuni told the participants that operational efficiency in revenue collections increased after they removed many illegal road blocks.
[11] World Bank (2015).
[12] Noted at the meeting of South Sudan’s Economic Cluster on 9 September 2011.

approve the government's plan to unify the exchange rate. The Central Bank of South Sudan circulated plans for a policy to devalue the currency. But within a few hours, influential individuals who stood to lose from such a policy lobbied parliament to overturn the decision to devalue the currency. The devaluation of the currency would have benefited producers and exporters, while hurting those that benefit from rents produced by the current dual exchange rate system. This instance serves to highlight the limitations of purely technically-led reforms, and the importance of first managing the political economy underlying reforms.

Possible policies and structural objectives

The path of production that South Sudan has pursued since its independence has proved to be unsustainable. Hence, strategies for economic development and diversification away from oil should entail addressing the following interlinked areas: (1) production, (2) trade facilitation, and (3) preferential access to external markets. South Sudan is starting from a production base of almost zero (beyond subsistence). Increasing production will require an active role by the government in addressing many of the current constraints (infrastructure, credit, land tenure system, corporate governance, etc.), particularly in a context where the economic activity of the private sector is limited and internal markets are unavailable/absent.

Improving trade facilitation will involve addressing behind-the-border constraints such as infrastructure, customs services, standards, pest and disease control/management capacity and vocational training in practical skills such as masonry, carpentry, and welding. Effectively managing preferential access to external markets will entail reducing tariffs incurred by South Sudan's exports, removing non-tariff barriers and meeting technical standards such as sanitary and phytosanitary requirements.

As we have discussed, South Sudan's economic development is undermined by weak productive capacity. Instead of exporting food items, South Sudan is importing almost its entire consumption basket. Other economic activities such as fishing, farming and cattle-rearing do not contribute much to national income and nor are they able to create jobs for most of the unemployed population. While South Sudan boasts vast tracts of land, only about 4.5% of it is cultivated. Lack of investment and modern inputs have meant that South Sudan's agricultural productive capacity remains limited.

4 Outlook for trade diversification

As a least developed country (LDC), South Sudan benefits from duty- and quota-free (DFQF) access to most developed country markets.

The World Trade Organization (WTO) DFQF provision for LDCs under the Doha Development Agenda requires developed countries to provide preferential market access for South Sudan's exports. The 2013 WTO Ministerial Conference in Bali further encouraged developing countries to extend DFQF to LDCs. If implemented, this will help South Sudan expand trade with the East African Community (EAC) (particularly Kenya and Uganda) and the rest of the world. The WTO agreement on trade facilitation calls on developed countries to support LDCs in implementing the agreement as well as improving trade facilitation infrastructure – a priority issue for South Sudan.

The European Union (EU) 'Everything but Arms' (EBA) provision allows South Sudan's exports (except arms and ammunition) DFQF access to the EU market. In 2014 improvements were made to the EBA rules of origin, which now allow up to 75% imported inputs in export products. Given that domestic supply chains have not yet developed, this change will help firms to emerge in South Sudan based on imported inputs.

The US African Growth and Opportunity Act (AGOA) provides preferential access for some of South Sudan's exports to the US. It covers about 7,000 tariff lines, which have DFQF access. Furthermore it contains liberal rules of origin on apparel, which permit the use of inputs (fabric) from third countries. Kenya, South Sudan's neighbour, is a leading exporter under AGOA. South Sudan should explore building linkages with Kenya's export value chain by facilitating production networks between the private sectors in Kenya and South Sudan. The South Sudan Investment Promotion Act provides tax incentives, faster registration and ease of incorporation to attract investments.

The EAC Common Market, consisting of Kenya, Uganda, Tanzania, Rwanda and Burundi, is on South Sudan's borders. This is a growing and dynamic regional market that provides opportunities for trade growth. South Sudan can engage with EAC by becoming a member of the Community or by expanding trade relations.[13] As a member South Sudan will be required to extend DFQF market access to existing Community members (though the period over which tariffs fall to zero can be negotiated) as well as adopt other agreements of the Community. Doing this would allow South Sudan to receive the full benefits of membership, and would help it to adopt regional best practices in good governance, mutual recognition, harmonising standards, restraint in expropriation, and enforcement of property rights. At a time when South Sudan is putting in place trade and infrastructure policy, adopting regional best practice could be advantageous.

[13] South Sudan applied in 2011 to join EAC and it begins formal negotiations on accession in April 2015.

The requirement for South Sudan to liberalise its tariffs to the other EAC members will have implications for tariff revenue. As data on imports from EAC members are unavailable, it is difficult to assess the full impact. A more cautious approach would be for South Sudan to engage with EAC on eliminating non-tariff barriers, building trade infrastructure and promoting private sector connections. Irrespective of how South Sudan chooses to engage with EAC, it should give priority to the regional and international market in its trade policy. In other words, South Sudan could begin by articulating a policy road map on diversifying the economy away from oil and for deepening trade linkages with EAC.

5 Conclusion

South Sudan enjoys favourable market access to export destinations in the region and beyond. But it has little other than oil to export. Increasing production, beginning with agriculture but including manufacturing and services, should become a central goal of economic policy. This will first require a shift in the political and economic dialogue in South Sudan (such as investing in agriculture, giving farm subsidies, setting up credit reference bureaux to ease bank lending and carefully enforcing property rights) to start prioritising issues of production, which have thus far received very little attention.

South Sudan should use its oil revenue to invest in building its productive capacity. This will help build the foundation for long-term prosperity. We argue that the following should be given priority in this respect.

1. *Further increase investment in the agricultural sector.* This will require large-scale investment in agricultural infrastructure (e.g. feeder roads in agricultural zones such as Western Equatoria and Upper Nile), expansion of extension services to all ten states of South Sudan for maize, sorghum, and livestock, provision of inputs and irrigation mostly for Renk plantation projects, Aweil rice and Nzara cotton schemes, access to credit, development of farmers' associations and so forth. In order to achieve this, the capacity of the Ministry of Agriculture, line ministries and sub-national government to plan, organise and invest will need to be increased.
2. *Promote small and medium enterprises*. It will be difficult for South Sudan immediately to overhaul the infrastructure necessary to expand value-adding activities. It might therefore be worth exploring a clustering approach for SMEs in urban areas, so that the infrastructure and institutional requirements for the efficient functioning and expansion of SMEs are made available. Also promote production networks with private sector in neighbouring countries such as Kenya, Uganda and Ethiopia.

South Sudan is in a precarious state. Without peace, sustained and inclusive economic development cannot take root. And without economic development, peace and prosperity rest on unstable foundations. It is clear that there is no magic wand to solve this impasse. None the less, it is important to recognise that peace and economic development are interconnected, and that only by investing in both will long-term prosperity be secured. This has not been the case to date, and in the absence of adequate investment in productive capacity South Sudan has found it difficult to exit the cycle of conflict.

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