Looking Beyond the Crisis: Challenges and Opportunities for Africa

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Introduction: Good Trajectory Derailed by Crisis

In a refreshing break from its stagnant past, Africa made remarkable progress after 1995 on the back of improved policies, institutions and governance as well as debt relief. For the first time in 2006, according to the OECD's Development Assistance Committee, private capital flows to Sub-Saharan Africa at $48 billion exceeded official flows at $40 billion. A striking index of change is the positive manner in which governments managed the commodity boom period which preceded the global crisis. Countries which we might well have regarded as incorrigible vastly improved fiscal management, putting away rainy-day funds, bringing down indebtedness and ushering in greater transparency. I speak from personal experience, from my tenure as Nigerian Minister of Finance from 2003 to 2006. As a result of reform and growing political stability, growth rates went up between 1995 and 2007, putting Africa on a good trajectory.

Then crisis-after-crisis intervened like the slings and arrows of Hamlet's outrageous fortune. Starting in 2007, Africa along with the rest of the developing world was hit by the food, fuel and fertilizer crisis. The hallmark of this crisis is captured in the following assertion by an agricultural economist in a meeting I once attended: "You tell me the price of gasoline and I'll tell you the price of food." As we know by now, biofuels were a major factor in hitching food to fuel prices and driving them up. As a result, food prices which were earlier reasonably stable have now become much more unpredictable because oil prices are among the most volatile in the world. Although food prices have fallen from the historic highs of the past year, we know that the trend is up. Real food commodity prices are forecast to be on average about 25 percent higher during 2009-2018 than over the 1999-2007 period, driven by higher transportation costs, higher demand for biofuels and livestock products and exchange rate movements. Further, as a result of climate change, the occasional drought has morphed into the more frequent and more devastating

drought, as has the occasional flood, making food security a concern in LICs. And now we are contending with the impact of the global financial and economic crisis on Africa, bringing in the fourth f: finance, to add to food, fuel and fertilizer. Africa was spared the first round effects of the crisis because of its limited financial integration with the industrial countries, South Africa and to a smaller extent Nigeria and Kenya being exceptions; but the crisis is now taking a toll through the channels of commodity prices, FDI especially in the natural resource sectors, remittances, tourism and a possible slowdown in aid flows. Significant job losses have been incurred. For example, DRC lost 200,000 jobs and Zambia 10,000 jobs in the mining sector and 1,500 jobs were lost in wood manufacturing in Cameroon. Most African countries have been hard hit and need to cope with the crisis while positioning themselves for a return to fast growth once the crisis ends--because this crisis, like its predecessor the Great Depression, will one day surely end. As Larry Summers said in March, when the situation was at its bleakest, "….there is one ineluctable lesson of the history of financial crises: they all end."

Indeed, the latest data from the US, France and Germany indicate that the green shoots of recovery are taking hold sooner than we might have expected. The IMF's July World Economic Outlook forecast has upgraded world growth for next year to +2.5 percent on a PPP-weighted basis from +1.9 percent in its earlier April forecast. Growth in the advanced economies is now expected to be +0.6 percent in 2010 compared to zero in the earlier forecast. But jobs will continue to lag behind for several more months, the recovery is regarded as fragile and growth is likely to be slow in the medium term. A key factor in the upgrading of growth forecasts for next year has been the decisive and innovative fiscal and monetary measures taken in the rich countries as well as China, which have naturally been anxious to avoid the mistakes from the Great Depression. As a result, the increase in the US fiscal deficit in fiscal year 2009 compared to 2008 is expected to be 8 percentage points of GDP—more than twice the combined income of all low-income countries for 2008! And the balance sheet of the Federal Reserve has ballooned to more than twice its pre-crisis size. Any developing country trying to imitate this would suffer an

immediate and sizable ratings downgrade. Yet Moody's just last week confirmed that the triple-AAA sovereign debt ratings of the US and UK are not at risk.

For developing countries, the earlier-than-expected recovery in the OECD countries, albeit fragile, is good news because these are key export markets. But there is considerable variation among developing countries, with much of the growth expected to come from China and India. Many of the smaller, more-trade dependent economies in Asia and Africa are expected to lag behind. Looking beyond the crisis, the vital question for Africa is how to make even deeper inroads into poverty reduction through creating jobs, especially for its burgeoning youth. In dealing with this question, Africa faces seven challenges: One, sharpening the role of the government; Two, keeping public debt on a sustainable path; Three, managing volatility; Four, fighting corruption; Five, promoting political stability and social harmony; Six, dealing with climate change; and Seven, accelerating growth. And wrapped up in these challenges are four opportunities: One, promoting labor-intensive manufacturing; Two, raising agricultural production and productivity; Three, seeing climate change as an opportunity; and Four, recovering public assets stolen by corrupt officials, which could serve as a valuable source of development finance.

Challenge 1: Sharpening the Role of Government

The role of the government is going to be more important than ever in post-crisis Africa because there is going to be even less room for error. Governments needs to maintain the pre-crisis reform momentum while giving even higher priority to public debt sustainability and managing volatility, two old challenges which the crisis has given a new twist.

In the midst of all the hand-wringing that is going on about the futility of macroeconomics—something which Paul Krugman regaled you with during the recent Robbins Lectures right here at the LSE— and the massive intervention in the markets in the West, the rededication to reform in Africa stands out. The communiqué from the November 2008 Tunis conference of African finance ministers and central bank governors should allay any fears of

large-scale policy reversal, and I quote: "[African central-bank governors and finance ministers] agreed…to deepen economic reforms in the full conviction that such reforms have served African countries well, yielded strong macroeconomic stability, fostered growth and resilience to external shocks." But actions speak louder than words, so let me give you some concrete examples:

- Zambia is running a modest fiscal deficit (2.6 percent of GDP) while maintaining the medium-term expenditure program it had established before the crisis.
- Tanzania's emergency program includes government support to the banking sector that is strictly time-bound, something that the U.S. program lacks.
- The Democratic Republic of Congo used an emergency credit from the World Bank to finance infrastructure maintenance and teachers salaries.
- Nigeria is planning to deregulate its downstream petroleum sector, which will generate substantial savings from reduced subsidies.

These examples show that African countries are attempting to live within their means while protecting key expenditures and sticking to the pre-crisis reform path as closely as possible despite the severe impact of the crisis.

Is this going to be enough in the post-crisis world? My colleague and chief economist at the World Bank, Justin Lin, has been arguing that the state should play a 'facilitating role' consistent with a country's comparative advantage as determined by its endowments. "Facilitating" means helping with technological upgrading and productivity growth in two ways: by subsidizing innovation; and removing constraints to the adoption of new technology by "….simultaneous improvements in education, financial and legal institutions, and infrastructure". But Justin is equally emphatic about what governments should not do: they should avoid "….high levels of protection and subsidies" which would distort market signals and end up wasting resources.

So if I were to adapt what Justin is saying, African governments need to give a push to firms which are in labor-intensive sectors and which are proving themselves by new innovations

that pass the market test, especially in export markets, while enforcing hard budget constraints, promoting competition and investing in people and in infrastructure.

The perennial policy question is how to do this without squandering resources as has often happened when governments tried to pick winners. I shall return to this challenge when I discuss the opportunity in labor-intensive manufacturing later in my speech.

Challenge 2: Debt Sustainability

Many low-income countries in Africa can expect to benefit from debt relief and substantial debt write-offs under the Heavily Indebted Poor Countries program and the Multilateral Debt Relief Initiative, the so-called HIPC-MDRI process, or other avenues like my country, Nigeria. Then why am I raising debt sustainability as a challenge? For three reasons:

First, the 53 poor countries which had reached decision point by the end April 2009 can expect to have their external public debt stock reduced by more than 80 percent once all sources of debt relief are included; but the process is not yet complete.

Second, simulations done even before the global crisis intensified showed that debt sustainability remained a concern for no less than 60 percent of the 26 post-completion point HIPCs—those which have already benefited from debt write-offs. Besides, these calculations do not take domestic debt or the costs of meeting the Millennium Development Goals into account.

Third, debt sustainability is going to be a bigger challenge than ever in post-crisis Africa. With growth rates slowing and the outlook for fiscal revenues worsening plus the prospect of higher world interest rates, African countries will find their debt burdens rising especially if governments want to maintain core spending to preserve a platform for fast growth once the crisis ends. For this, core spending—defined as spending on health, education, social safety nets and O&M for infrastructure—will need to be protected. Borrowing more will take African countries back to square one.

What else can be done? Wasteful expenditure can be cut out, as Nigeria is aiming to do with petroleum subsidies. Likewise, payrolls can be exorcised of ghost workers, thereby

rationalizing the government wage and salaries bill. This is also a good time to improve tax administration to ensure that compliance improves and the tax burden is fairly distributed. But this will not be enough given the magnitude of this crisis and the possibility that Africa will recover only with a lag. That's why it is so important to find additional concessional funding to preserve core public spending, thereby protecting the progress African and other low-income countries have made in reducing poverty and improving social indicators.

Challenge 3: Managing Volatility

Managing volatility from exogenous sources will continue to be a top priority. Studies show that large episodes of volatility are the ultimate culprit in hurting long-run growth in poor countries. Right now, African countries are battling one of the biggest external shocks they have encountered in decades. As I just mentioned, the immediate priority is take steps to prevent the emergence of another debt problem which would then make it harder to cope with adverse exogenous shocks in the future, for example, from the terms of trade or drought, because fiscal revenues will be used up for debt service instead of being spent on infrastructure and the social sectors. Not only will this serve to amplify the shock since there is no way to cushion its effects, the cuts in infrastructure and social spending will harm long-run growth.

There is a special challenge for oil exporting countries, which account for 30 percent of Africa’s population. Even countries like Nigeria, which managed the oil boom period very well through a combination of countercyclical fiscal policy based on a conservative reference price for oil and greater transparency in the recording and use of oil revenues, remain excessively dependent upon commodity exports. While the improvements in fiscal policy have served to cushion the non-oil economy from oil price fluctuations, thereby helping agriculture in particular, oil still accounts for the lion’s share of exports and fiscal revenues. Good countercyclical fiscal policy helps, but is evidently not enough to achieve diversification. Therefore, an explicit diversification strategy is needed. Two opportunities exist, in labor-intensive manufacturing and agriculture, which I shall discuss later.

Challenge 4: Fighting Corruption

Notwithstanding the improvements in governance and fiscal transparency over the past decade, fighting corruption remains a big challenge in Africa. Given the sharp crisis-related decline in Africa's growth rate, more concessional funding and aid will be needed to avert or at least minimize a potential human crisis. But Africa cannot continue to seek aid while simultaneously allowing its public resources to be stolen and siphoned out; moreover, these stolen resources, which are often spirited overseas, could become a significant source of development finance if repatriated. Countries cannot seek $20-30 million in aid while hundreds of millions are siphoned out. Corrupt money associated with bribes received by public officials from developing and transition countries is estimated at $20 billion to $40 billion per year—a figure equivalent to 20 to 40 percent of flows of official development assistance (ODA). Initiatives like the Stolen Asset Recovery or StAR initiative launched the in 2007 by the World Bank and the United Nations Office on Drugs and Crime to help developing countries recover the proceeds of corruptly acquired public assets lodged in overseas financial havens can help.

Challenge 5: Political stability

Political stability is crucial as illustrated by Kenya's experience. Kenya began implementing significant reforms in the early 1990s but growth did not take off until 2003. While the benign external environment helped the take-off, surveys indicate the successful and peaceful December 2002 presidential election was the critical factor in lowering political risk and fostering stability, thereby improving the investment climate. Unfortunately, the December 2007 presidential elections and the violence which followed has been a severe setback, although the subsequent formation of a national unity government is a positive step in restoring stability.

Entrenching political stability is a crucial challenge for Africa and must be seen as an integral part of its "new normal". Prior to the financial crisis, there was an encouraging trend. Longstanding civil wars in Liberia, Sierra Leone, DRC, and Ethiopia ended. Landmark elections resulted in the installation of the first woman African president in Liberia, an opposition party

victory in Mauritania and an end to military rule in Sierra Leone. But a new cycle of instability is starting with events in Mauritania, Madagascar, Guinea Bissau, Zimbabwe and now Gabon.

African politicians need to recognize that there is a "neighborhood effect" on growth: the bad press from political instability in one country tarnishes the entire continent's image. It is laudable that Africans are no longer willing to turn a blind eye to this, and this is having an impact. For example, the African Union and regional organizations such as ECOWAS and SADC played catalytic roles in helping to re-establish order in Mauritania, Madagascar, Guinea Bissau and Zimbabwe.

Challenge 6: Climate Change

Africa is the continent most exposed to the ravages of climate change even though its contribution to the problem has been small. The seminal work done by your very own Lord Stern, my former colleague at the World Bank, points to this. As we speak, unprecedented floods across Africa are displacing hundreds of thousands of people. By coincidence, the Bank's World Development Report for 2009, which is on development and climate change, is being released today. According to the WDR, no matter what is done, temperatures are going to rise by a minimum of 2° C. And even if the temperature increase is contained to 2° C, annual per capita consumption in Africa will fall permanently by 4-5 percent, according to the Stern Report; the reach of malaria, already the biggest killer in Africa will spread to higher altitudes, putting 90 million more people at risk; countries like Ghana will incur heavy output costs associated with malnutrition and diarrhea stemming from the impact on water and ecosystems; and 10-15 percent of African species will be lost.

Climate change represents a particular challenge for rain-fed agriculture, which employs 70 percent of Africa's population. The challenge is therefore to minimize drops in yields as a result of changes in weather patterns. As much as 9-20 percent of Africa's arable land will become much less suitable for agriculture. Africa must also move away from biomass fuels, which exacerbate deforestation and contribute to indoor pollution leading to respiratory diseases.

Another challenge is augmenting Africa's energy sources in order to accelerate growth: no country has ever grown and developed without adequate energy supplies. The combined power generation capacity in the 48 countries of Sub-Saharan Africa at 63 gigawatts equals that of Spain, which has one-twentieth the population of Africa! And of Africa's 800 million people, 70 percent do not have access to modern energy, resulting in the use of biomass with its negative implications of deforestation and indoor pollution. Mitigation and adaptation present significant opportunities for Africa, as I shall discuss later.

Challenge 7: Accelerating Post-Crisis Growth

Until 2008 when the food and fuel crisis hit, Africa's GDP growth had been averaging 5 percent a year for a decade. Over this high growth period, poverty declined at a faster rate than in South Asia; health and education indicators were improving (albeit from a low base); and there were signs that Africa's HIV/AIDS prevalence rate had begun to decline. But the growth spurt was 'jobless' in that it did not create sufficient employment opportunities for the burgeoning numbers of African youth.

Besides, while this growth spurt brought Africa in line with the trends for other developing countries, it lagged countries like China and India. Therefore, what Africa needs is a prolonged dose of even more rapid, job-creating, growth in order to catch up. Nigeria's GDP per capita is only about two-thirds that of India on a PPP basis while those of Burkina Faso, Ghana, Uganda and Mozambique –all good growth performers over the past decade with differing endowments and geography--are less than one-half. So these countries have a long way to go before they catch up even to India's per capita income levels, leave alone China's! The challenge therefore is to return to the pre-crisis growth path and then raise the growth rate beyond it, all this in a post-crisis world grappling with global imbalances, a likely reduction in cross-border capital flows, a possible rise in protectionism and uncertainties regarding aid. Accelerating growth post-crisis is Africa's biggest challenge with little if any room for error!

What can Africa do to help itself? It can borrow from the Growth Commission, which released a report in 2008 written by several prominent practitioners and two Nobel Prize winners on strategies for sustained growth. I plead guilty to being a member of the Commission. Its report lists the five common underlying patterns or ingredients it found in countries which grew rapidly, i.e. at 7 percent or more per year for at least 25 years. These include macroeconomic stability, future orientation, good governance with a focus on inclusive growth, trade openness and an emphasis on market incentives and decentralization. Africa needs to do all this while also investing in health and education, in infrastructure and in agriculture as well as developing social safety nets. Africa can also promote openness through expanded regional and external trade, which would enlarge and open up markets while increasing competition.

All this is reasonably well-known. The main remaining challenge is how to increase the productivity of labor, land and capital through technological upgrading. Four opportunities are available to achieve higher productivity and accelerate growth: promoting labor-intensive manufacturing and gradually upgrading technology including by learning from the Chinese and Indian examples; increasing production and raising productivity in agriculture; taking advantage of the climate change agenda to create ‘green’ jobs while also upgrading technology; and recovering stolen assets as a means of financing better infrastructure and investing in people.

Let me now turn to the opportunities.

Opportunity 1: Promote Labor-Intensive Manufacturing

Labor-intensive manufacturing is a channel for Africa to upgrade technology and thereby raise the productivity of workers. China presents an opportunity: It is already investing heavily in infrastructure in many African countries. These countries need to actively woo Chinese manufacturing companies, especially those in mature, labor-intensive sectors which are feeling the need to transition to more sophisticated, capital-intensive products. Such companies might find it profitable to relocate their plant and equipment to Africa provided they find a hospitable environment there or a willingness to create one through working to upgrade infrastructure,

nurture a well-trained, disciplined workforce and assure stability in the rules of the game for the private sector. This would be an effective, relatively low-risk way for African countries to move up the manufacturing food chain in sectors like textiles, footwear, manufacture of small consumer durables and other low-tech consumer goods.

Opportunity 2: Agriculture

Agriculture presents an enormous opportunity which Africa simply cannot afford to squander. It must first of all be able to feed its own people through supporting smallholder farmers and the continent has what it takes to do this. But only a small fraction of total arable land, about 40 percent, is now being cultivated. Therefore, there is substantial potential for increased production and job creation. In this regard, large-scale commercial agriculture offers a distinct opportunity in which considerable foreign investor interest has already been expressed. The amount of suitable arable land is estimated at potentially up to 500 million hectares. Africa is capable of much more than just producing enough food and agricultural products for itself; it is in a good position to export. To do this will require large-scale, efficient agricultural management and production. Let me be clear. I am not advocating commercial estates at the expense of our small farmers. Quite the opposite. I am saying we must take steps to raise the productivity of our small farmers; but even after this, there is potential for larger scale commercial enterprises. Such enterprises will also provide opportunities for smallholders as outgrowers and wage workers, enabling win-win structures that simultaneously benefit commercial and small farmers.

Bringing this win-win opportunity to fruition is going to require technology acquisition, a stable regime for contracts, marketing innovations with linkages to outside markets and large infrastructure investments. Several countries including Japan, Saudi Arabia and South Korea have already expressed interest in agricultural investments in Africa.

But in pursuing commercial agriculture, there are also pitfalls to avoid. For example, an African country has advertised 2.5 million hectares of land available for private investment in oil palm, rice, and cotton using highly mechanized cultivation. Few jobs are likely to be created. According to a senior official, land is to be provided at $10/ha on 50-year leases to companies that will enjoy a tax-free status and not pay for water. This could have harmful implications for food security, social stability, and environmental degradation. This example illustrates that commercial agriculture must be pursued with due care exercised to protect the rights and socio-economic fabric of local people. The World Bank Group is working together with beneficiary countries and investors on a set of principles to guide such investment.

Opportunity 3: Climate Change

Africa can augment its energy supplies by tapping its vast renewable resources, such as hydropower, of which only 8 percent is currently exploited compared to 30 percent in Latin America. For this, it will need access to new technology and finance.

Investing in sustainable agricultural land management can enable soil carbon sequestration and contribute significantly to greenhouse gas mitigation. This could also have spinoff benefits for soil fertility, agricultural productivity and food security. Agricultural carbon sequestration could generate annual revenues of close to $1.5 billion which could be ploughed back – pardon the pun – into improving Africa's agricultural sector. But this would require that agricultural land management be included in future climate regimes so Africa can benefit from the global carbon market and contribute to climate change mitigation.

The rich countries can help in two ways: by underwriting the development and transference of the necessary technologies; and reducing their own carbon footprint. The emissions increase resulting from providing electricity access to all 1.6 billion people in the developing world who do not now have it could almost be fully offset by replacing all SUVs in the US by fuel-efficient passenger cars!

So it is essential that climate change be seen as a major development opportunity for Africa given the anticipated increase in its energy requirements as growth accelerates, the scope for meeting at least part of this through renewables and the vital potential agriculture offers as a source of diversified growth *and* mitigation. A three-pronged strategy is needed: encouraging commercial agriculture as a win-win along the lines I mentioned; better types of seeds, drought resistant crops, and improved management of land and water resources; and ensuring Africa is included in adaptation and mitigation financing, including playing a role in carbon sinks and cap-and-trade mechanisms for emissions control.

Opportunity 4: Recovering Stolen Assets

The crisis has focused considerable attention on tax havens in the rich countries. However tax havens are also StAR havens: or places where stolen public assets from low-income countries, many of them in Africa, are lodged. Low-income countries can piggy-back on the indignation directed towards tax havens by the rich countries in order to underline that the theft of public assets from poor countries in Africa deserves equal prominence and rectification. Recently, the United Sates compelled the Swiss bank UBS to disclose the names of its citizens who had undeclared bank accounts there on the suspicion that such accounts may harbor income on which US taxes have been evaded. Wouldn't it be wonderful if the bank accounts of politically exposed persons from Africa were similarly disclosed!

I would urge African countries to take advantage of the StAR initiative as part of their anti-corruption programs. Repatriating stolen funds would provide a badly-needed source of financing for infrastructure and the social sectors, thereby contributing to higher productivity and faster growth. In addition, StAR would serve as a major disincentive to stealing public assets in the first place because the word would go out that there is no safe haven for such assets as prestigious banks desirous of protecting their reputations would no longer want to be associated with such transactions. Making this work will also require the cooperation of countries whose

financial systems and banks serve wittingly or unwittingly as accomplices in such theft, the ‘other side of the equation’ as I like to call it.

Conclusion

To conclude, the ongoing crisis is probably the biggest external shock Africa has ever faced. The priority is to protect the progress that was made during the decade preceding the crisis while laying the foundation for even faster growth with more diverse sources. The continent is going to have to deal with a number of old challenges, like managing volatility and debt sustainability, which come with a new twist as a result of the crisis. But significant opportunities are presented by labor-intensive manufacturing, commercial agriculture and the global climate change agenda, which Africa must seize if it is to accelerate growth, create jobs and make deep inroads into its poverty.

I want to end with the following thought: as Africa confronts its challenges, seizes its opportunities and seeks to take its rightful place in the world polity, the continent and its leaders must assume the responsibility for shaping their own destiny. The crisis has injected a palpable sense of urgency which I’m positive will be accompanied by innovation in crafting new, pragmatic approaches. As the Roman poet Horace noted many centuries ago: “Adversity has the effect of eliciting talents, which in prosperous circumstances would have lain dormant.” Frankly, Africa has no option but to rise to the occasion.

Thank you for your attention.

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