# Caleb M Fundanga: Employing African resources for African development

Speech by Dr Caleb M Fundanga, Governor of the Bank of Zambia, at the 2009 Africa Investment Forum, Istanbul, 5 October 2009.

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## Introduction

I feel particularly honoured and grateful to be a discussant at this important forum, whose theme is "Employing African Resources for Africa's Development". This forum could not have come at a more opportune time than now when all our economies are faced with the challenges emanating from the impact of the global financial and economic crisis. This seminar is also timely in that the fiscal policy response is going to play a large role in determining how well African economies emerge from the financial crisis. This is because Africa must sustain and enhance investment flows in infrastructure, energy, health and education if it is to accelerate the growth momentum achieved prior to the crisis. The question of resource mobilisation for development, whether this is at a national, regional or international level, is thus something that policy makers in Africa are grappling with.

## Global financial crisis and Africa's development

For most of the current decade, several African countries have been registering positive economic growth rates averaging 5.3 percent between 1999 and 2008, with growth in Sub-Sahara Africa slightly higher at an average of 5.6 percent over the same period.[1] This growth has contributed to rising income levels in several African countries leading increased investments in education, health, water sanitation and general infrastructure development. However, despite improvements in growth witnessed since 1999, significant reductions in poverty will not occur without a significant increase in growth rates to above 7% on a sustained basis. One of the ways in which growth can be scaled up is through the employment of the vast African resources for the development of the continent.

Prior to the global financial and economic crisis, the African continent experienced a surge in investment flows in many sectors including mining, manufacturing, tourism, transport and construction. This inflow of foreign capital helped to finance the development registered in Africa over the past decade. The inflow of foreign capital coupled with high prices of commodities on the global market led to high international reserve accumulation in most commodity exporting countries, including those in Africa. However, following the global financial and economic crisis the accumulation of international reserves declined as commodity prices plunged and foreign capital inflows, both private and public slowed significantly or were reversed. This has had a negative impact on the availability of resources to finance Africa's development.

The challenge going forward is recovering, maintaining and sustaining the economic gains and macroeconomic stability that African countries experienced before the crisis hit. In view of the anticipated reduction in aid flows and foreign direct investment, African countries need to give domestic savings mobilisation as much attention as the other foreign sources of development finance. In this respect, African countries may have to consider the utilisation of domestically generated resources such as international reserves', pension funds as well as the enhanced use of stock markets in raising financial resources required to finance development in Africa. However, it is important to stress that the effective utilisation of

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[1] IMF World Economic Outlook Database, April 2009.

resources will be dependent on the credibility of the institutional frameworks within which these resources are deployed and the quality of the projects themselves in terms of their economic and social returns.

## Sources of development finance

### *(a) International reserves*

The global economy has witnessed an unprecedented accumulation of foreign exchange reserves in the last ten years, particularly in developing countries and Africa has been no exception. According to the IMFs currency composition of official foreign exchange reserves (COFER), between 2001 and 2008 total world reserves increased by 227 percent from US$ 2,049.6 billion to US$6,702.3 billion while emerging and developing country foreign reserves grew by 418 percent from US$ 818.1 billion in 2001 to US$ 4,237.7 billion in 2008. The rapid build up in foreign reserves resulted mainly from high commodity prices and increased portfolio and foreign direct investments in emerging and developing countries.

Most developing country central banks approach foreign reserve asset allocation with a view of preserving capital and liquidity. This normally means that central banks invest in low risk, highly liquid assets with short-term investment horizons. It is noteworthy that the majority of the foreign reserves, which are held outside the African continent, entail an opportunity cost for developing countries as these resources are not used to finance development. In addition, the global crisis has brought to the fore the inherent risks in the placement of reserves with international fund managers with the collapse or near collapse of some of the worlds' leading asset managers such as Lehmann Brothers, Bear Stearns and Fortis, threatening the safety of the continent's international reserves. Further, with the reduction in interest rates in developed economies where most of the foreign reserves are held, the returns on these investments have declined drastically, thereby increasing the opportunity cost of these reserves.

These developments present an opportunity for African countries to consider foreign exchange reserves as a possible source of development finance for the continent. Such a strategy could make a significant amount of additional resources available for investment in infrastructure development and the provision of trade finance to stimulate expansion and diversification of African economies. In addition, African countries could consider investing part of their reserves in African multilateral financial institutions like the African Development Bank, the PTA bank, AFREXIM Bank as well as local development banks, which play an important role in the provision of development finance in Africa. The investment of part of Africa's foreign reserves in credible financial institutions can augment the resources available to these institutions, thereby enabling them to provide more financial resources for the development of the African continent.

For instance, in 2007 total foreign reserves held by African countries amounted to US$371.4 billion translating into an average of 9.2 months of import cover for each country. In the same year the African Development Bank (AfDB) raised funding from international capital markets amounting to UA724 million (US$1,144 million) at a weighted average cost of 6-month US Dollar LIBOR minus 32 basis points.[2] The amount raised by the AfDB accounted for a mere 0.3% of the total reserves for African countries as at 2007.

Hence, an allocation of some of African countries' foreign reserves to fund African development institutions in which most of the countries are members would greatly enhance

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[2] African Development Bank Annual Report, 2007.

the capacity of these institutions in the provision of development finance, thereby assist the continent's development programmes and poverty reduction efforts.

In summary, it is important for African countries to consider alternative ways of making use of foreign reserves in the financing of development using resources that are already available, including the direct use of foreign reserves in financing development and making available part of the reserves to African multilateral development institutions to augment the resources available in the financing of African development.

### *(b) Pension funds*

African countries need stable sources of development finance and as long-term investment vehicles, pension funds seem intuitively to be one potentially good source of domestically generated financial resources. Cognisant of the important role this resource can play, it is noteworthy that African countries embarked on financing economic development using US$300 billion held by domestic pension funds in 2007 in an effort to reduce reliance on foreign aid and foreign direct investment.[3] The report indicates that pension funds in South Africa, Ghana and Nigeria have already invested around US$625 million to fund pan-African infrastructure projects.

In Zambia, a study by FinMark Trust in 2007 indicated that pension and provident funds are a major potential source of capital. As regards the total amount of funds available in pension funds, the capacity of public and private sector funds is estimated to be greater than K2.5 trillion (about US$651.5 million). This is a considerable amount of resources which could be used in infrastructure development and other economic activity without resorting to expensive external financing from international financial institutions.

Currently, most pension funds in Zambia make short-term investments in highly liquid securities when they have the potential to do much more. It is imperative upon African Governments with the collaboration of cooperating partners to devote as much attention and energy to domestic savings mobilisation for investment purposes. In Zambia, for example, part of the reform process in the financial sector has been to establish investment guidelines for the public pension funds and the aspect of investment in infrastructure and other economic activity can be part of the guidelines to enhance the use of domestically generated savings in financing development in Africa.

Pension reforms if correctly done can also have a significant impact on financial market development when pension funds are encouraged to act as institutional investors involved on the capital market. Participation of pension funds in the capital market can lead to improved clearing and settlement on the one hand, as well as provide more sensitive price information – resulting in better resource allocation, and increasing the availability of capital for financing development. In some developing countries such as Chile, pension funds facilitated internal resource transfers, enabling the government to service its international debts without extreme fiscal adjustment and avoided the drainage of resources that emanates from foreign debt payments. In addition, the funds provided a source of borrowing that did not require excessively high interest payments. Africa can learn from such experiences and undertake necessary reforms to unlock this kind of resource. Pension funds can therefore offer African countries an alternative source of development finance, provide an avenue for restructuring public finances and for the promotion as well as development of the capital markets.

[3] Harvey Morris, 'African states tap pension funds', in the *Financial Times*, 24 October 2007.

### *(c) Stock markets*

Another important avenue for harnessing resources for the financing of development on the continent is the stock market. Stock markets have grown in number across the globe over the past two decades and emerging and developing country markets have accounted for a significant share of this growth. In Africa, new stock markets have been established in countries such as Ghana, Malawi, Swaziland, Uganda, and Zambia. Stock market development has assumed a developmental role in global economics and finance following the impact stock markets have exerted in corporate finance and economic activity. Stock markets enable firms to acquire much needed capital at relatively lower cost, hence facilitating capital allocation, investment and growth. The stock market also plays a resource mobilisation role by encouraging savings through the purchase of equities that meet investors risk preferences and liquidity needs.

On the important role of stock markets in financing development, it is noteworthy that some studies undertaken by the IMF have shown that the stock markets have contributed to the financing of the growth of large corporation in certain African countries such as Ghana, South Africa, Zimbabwe and Mauritius. It is therefore imperative for African countries to develop this avenue of financing development to enable companies to raise capital at relatively lower cost. Furthermore, the development of a well functioning stock and capital market can help Africa access long-term debt in local currency thereby providing much-needed financing for the constantly growing infrastructure needs in the African continent. Developing national and regional bond markets and secondary capital markets in general can also help in channelling excess banking sector liquidity into productive sectors.

### *(d) Natural resources*

There is little doubt that natural resources in Africa will continue to play a significant role in Africa's development efforts. However, African countries must learn from the past on how well to manage commodity booms and ensure the productive use of financial resources generated from natural resources. African countries need to invest the resources arising from the exploitation of natural resources in domestic capital formation in order to generate a higher sustainable income that compensates for the depletion of a wasting asset. In this regard, it is important that commodity booms are managed in a manner that benefits African economies through careful planning and the deployment of appropriate strategies.

Commodity swaps or barter system have been suggested in some quarters as an innovative way for Africa to get development finance taking into account the fact that most African countries are not able to borrow from the international financial institutions and are just coming out of heavy indebtedness. For this option of financing to be viable and profitable, there is need for commodity swaps to have a long-term positive impact of export diversification and economic growth for Africa. In this regard, commodities could be swapped for infrastructure development to address the large infrastructure gap that is inhibiting further growth and diversification, technology transfer and market access for manufactured goods. These commodity swaps would have to be carefully crafted so that future generations are not disadvantaged from the resources.

Currently, China has entered into such deals with countries like the Democratic Republic of Congo, Sudan and Angola and it would be interesting to see how these work and then other countries can learn from these countries experiences. The discovery of resources on the shores of the Continent should be carefully handled so that the funds that are realised as much as possible are used in the development of the African continent. Exploitation of the natural resources by foreign investors should ideally involve value addition on the continent. This is one way through which Africa would benefit from its rich resource base.

## Conclusion

The challenges of mobilizing domestic resources for the medium-to-long term development require higher levels of domestic resource mobilization. Africa needs a paradigm shift in terms of sources of development finance. This is because the resources that it has domestically in terms of official international reserves and pension funds can be used to finance infrastructural development and investments in other productive sectors of the economy. Capital markets can also be a source of finance for private and public sector investment projects. Africa needs to maintain the sound macroeconomic policies which led to the positive growth that the continent has witnessed in the last decade, and continue with policy reforms aimed at reducing the cost of doing business. This is the best way to ensure that domestic resources as well as foreign resources have a positive and long lasting impact on the African continent's economic growth and poverty reduction outcomes.