Rundheersing Bheenick: Whither Africa? – Or how the African continent is facing up to the challenge of the global financial crisis

Speech Mr Rundheersing Bheenick, Governor, Bank of Mauritius, at an international meeting of Rotarians, the "Rotary Institute Zone 20A", Balaclava, 4 November 2011.

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Rotarians from far and near, Good Morning!

Thank you very much for your invitation, relayed to me through my old friend François de Grivel. Let me assure you, François, that the slight hesitation, which you might have detected, before I responded had nothing to do with any fear that this was perhaps going to be yet another skirmish in our long-running battle on the value of our domestic currency – which, I may add for the information of visiting Rotarians, regularly pitches us in opposite camps. It had everything to do with the other matter: today is the day when all Mauritians wait with bated breath for the Minister of Finance to deliver his annual budget speech this afternoon. But how can one not respond to a call from those who put "Service above Self"?

I am delighted to address you at your Institute Zone 20A Convention today. Let me begin by extending a very warm welcome to our island-state to all visiting Rotarians.

Four years have elapsed since the largest financial and economic crisis in living memory, and perhaps the most complex ever, unfurled upon us. Policymakers around the globe are still struggling to find remedies as the crisis mutates and spreads and fails to respond to any treatment, even unconventional ones. While we can now claim to understand better the origins of the crisis, we continue to be baffled by its many manifestations. And we are no nearer to a sustainable global recovery than we were at the beginning. And we are even further away from preventing financial crises from derailing global development in the future. In the OECD countries, where the crisis is concentrated, governments may have rounded up the usual suspects, and named and shamed some culprits – like investment brokers, fund managers and bankers – but they have yet to deal with them effectively or indeed to tackle the underlying causes of the disaster that unfolded.

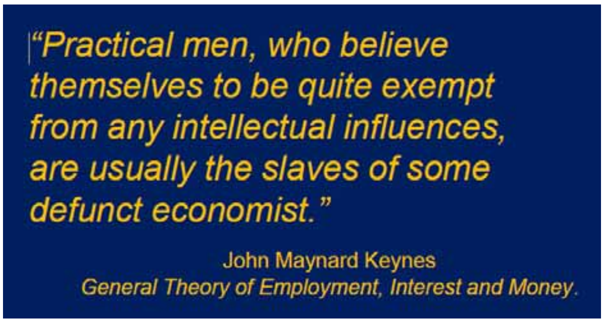
Some commentators have disingenuously claimed that the crisis was completely unforeseen and they were quite taken aback as it occurred following almost a decade of substantial global growth with low inflation. Terms like "the Great Moderation" and the "Goldilocks economy" became popular and well describe the mood of the times. Developing countries, and emerging markets particularly, had been doing well. Many countries in Africa seemed to have finally turned the corner, with their growth rates boosted by high demand for commodities. Global poverty was in retreat. There were reductions in civil conflicts. The democratic deficit decreased. There were improvements in governance. Changes in macroeconomic management and the policy environment held out hopes of fast and sustained growth. Africa was on the move, at long last.

And then the crisis hit! Severely denting growth prospects and dashing some of those hopes and aspirations. The growing sub-prime mortgage loan defaults in the US and the failure of Northern Rock in the UK in 2007 were not just mere harbingers of a crisis. They undermined growth and development prospects for the developing world. They compromised recent gains in poverty eradication. Three points made the financial crisis surprising, I suggest.

First, it originated in the US, the world's largest and richest economy, which everybody thought was robust and secure. Perhaps with hindsight, we should say, not "secure" but too extensively securitised for its own security and for the security of global markets.

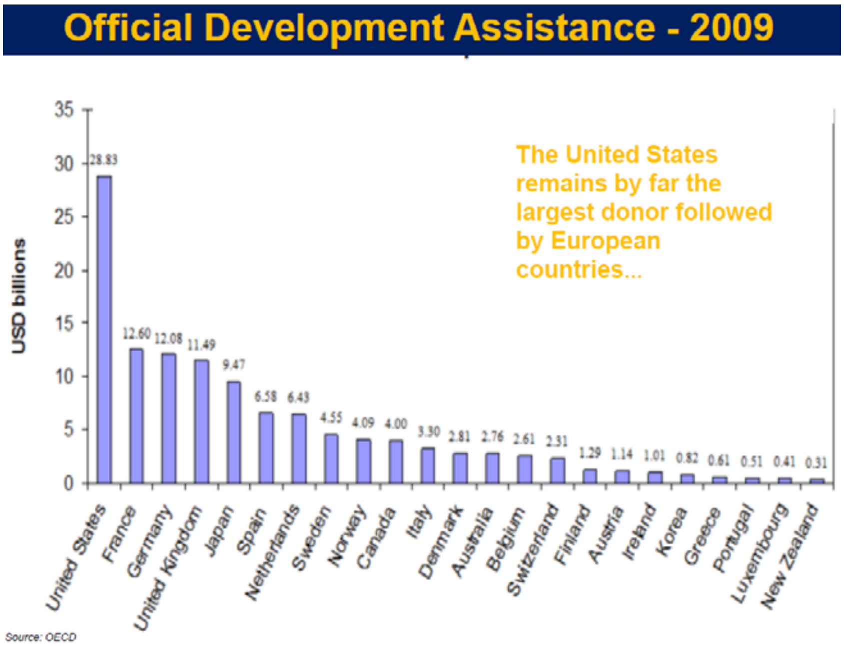
The second surprise was that it originated in the private sector, from an entrepreneurial flaw in the banking sector which had been producing wildly, enviously large profits for years. And the third surprise was that it led to a calamitous contraction in global trade.

Although initially feared, another "Great Depression" was averted, partly thanks to John Maynard Keynes, who taught that the Great Depression was "great" because governments in the 1930's failed to prop up aggregate demand. This time advanced countries responded by applying the lessons learned from that crisis by bailing out banks whereas many had been allowed to go bust during the Great Depression. They announced huge fiscal stimuli when, in the 1930's, only monetary policy had been initially engaged by the central bankers of the "big four" who blithely believed they could save the world. Keynes who had seen his major policy recommendations subjected to so much criticism in the years leading to the "Great Inflation", must be turning in his grave. Some of you may recall the famous words with which he ends his General Theory

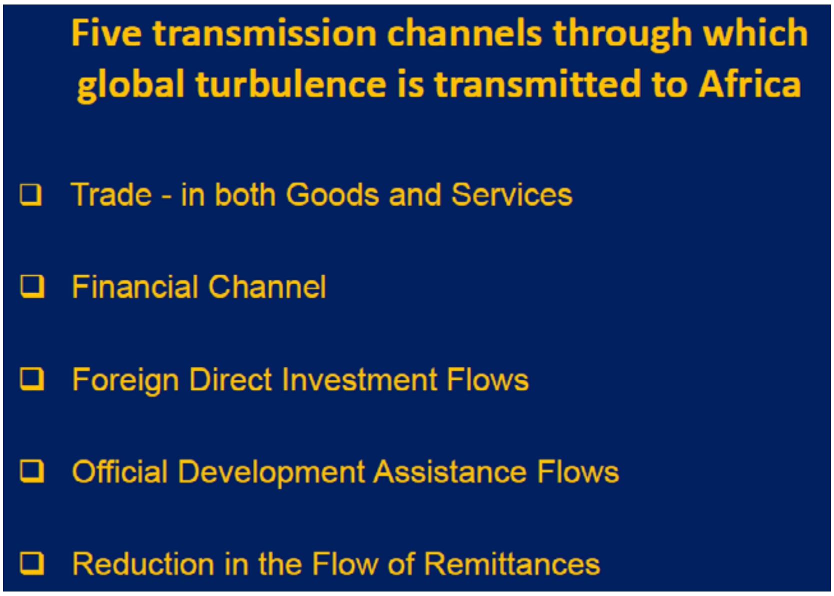


The defunct economist who has enthralled the practical men trying so desperately to cope with the current crisis is Keynes himself.

According to IMF estimates, the costs of stabilizing banks – in terms of injections of capital for bailouts, provision of liquidity, standby arrangements, and guarantees of loans and deposits – amounted to around US$11 trillion in developed countries, and another US$1.7 trillion in developing countries. US$13 trillion is a huge sum. It is, for example, about ten times the annual flow of Official Development Assistance from OECD's Development Assistance Committee members in 2008.



These problems of western finance, which induced a slowdown in the global economy over the past few years, are now referred to as the World Economic Crisis. One could ask why emerging and developing countries like us have not been as hard hit as Europe and the USA. Was it because of the immediate effectiveness of the stimulus applied in advanced economies? Was it because the bailouts extended to stabilize the financial sector, protected the innocent bystanders? Or is there some special element in the core resilience of these otherwise vulnerable states? The search for answers leads us to examine briefly the main channels through which this global turbulence is actually transmitted to Africa. We can identify five transmission channels.



First, trade, in both goods and services, is obviously the main channel with the colonial legacy reflected in the continued dependence on EU member states as the largest trading partners of Sub-Saharan Africa. Second, the financial channel is also very important and works through four different but interconnected ways. First is the exchange rate, with increased currency volatility affecting countries with floating rate regimes while the currency peg effectively transmits Eurozone uncertainties to the CFA franc zone. Second, African stock markets were severely hit as foreign investors withdrew in droves in an elusive flight to safety. Third, spreads on foreign-currency African bonds widened. And fourth, the domestic banking sector saw its access to foreign currency lines drying up as it shared in the growing risk aversion with rising spreads and declining credit.

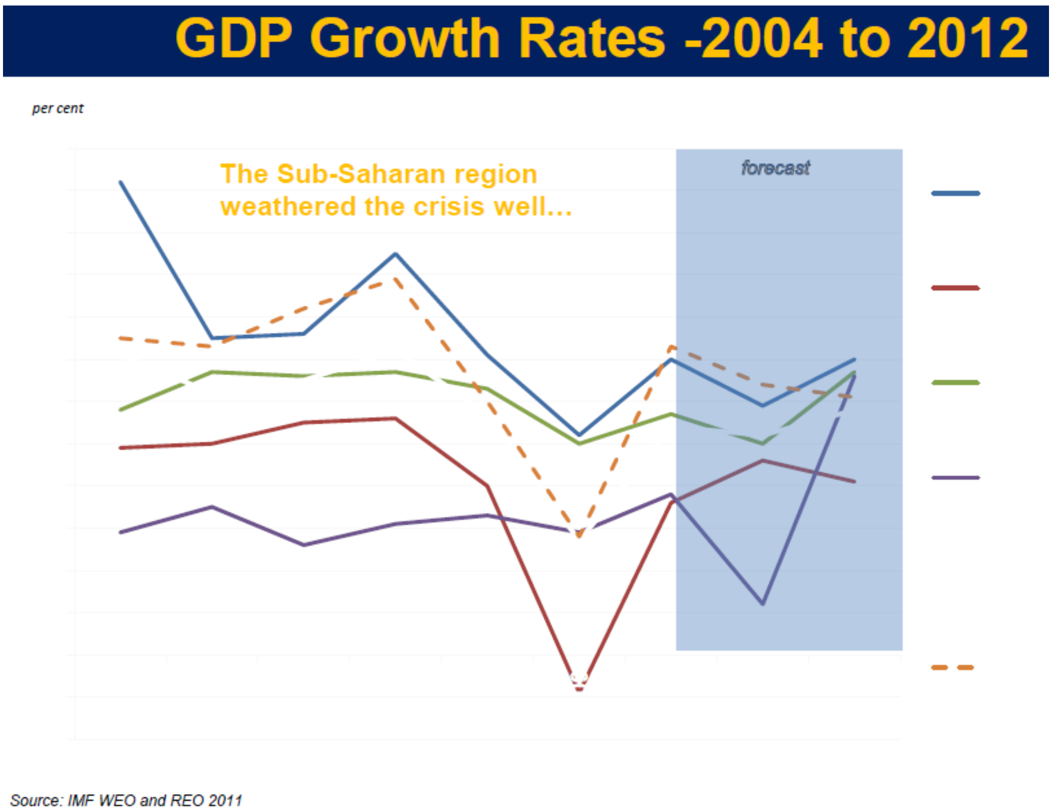
The third transmission channel is Foreign Direct Investment which African countries rely upon to make up for their domestic savings deficit. FDI flows can hardly be expected to grow unabated when the home countries, where these flows originate, are caught in the throes of a deep crisis. The fourth channel is the flow of Official Development Assistance, which plays such a critical role in supporting development in some of the poorest countries. Despite repeated renewals and reconfirmation of commitments to raise ODA flows to 1 per cent of GDP since the so-called First Development Decade, this pledge is unlikely to be redeemed when the source countries are going through such critical times. And the fifth channel whereby the crisis in the West is transmitted to Africa is via a reduction in the flow of remittances as rising unemployment and stagnating wages in home countries affect migrant labour and the African diaspora.

After this short detour to survey the various transmission channels, all of which affect African countries to varying degrees depending on the structure of their economies and their openness, let us revisit the question posed earlier. What accounts for the resilience of Africa to the global turmoil? The answer, I think, lies partly in a delay in the impact of this crisis – which is like a far-off tsunami taking some time to hit our shores. Part of the answer for the renewed resilience also lies in the major improvements in macroeconomic management, achieved by many African (and other developing) states over the last decade. Another part of the answer is found in the success achieved by many of them in diversifying their trade and investment partners. This was at the core of the policy response to the crisis and helped Africa weather the global turbulence.

In the larger and stronger developing economies, such as the BRICs (Brazil, Russia, India, China and one might add South Africa), recovery has been surprisingly rapid. More surprises! Indeed, one constant feature of the saga is that economists, investors, and the commentariat are continually surprised, having been previously gently rocked into a belief in a stable economic state of the world, massaged for some by Keynesian principles and, for others, by a blind faith in the power of benign, self-regulating, markets. But I digress. This surprising recovery in the BRICs has been supported by the adoption of countercyclical policies, with a cumulative total spending of around 2.7 per cent of their GDP on fiscal stimuli.

In many African countries, including the most fragile, governments have made bold attempts to shelter their economies. In those where there was adequate fiscal space, as here in Mauritius, agile governments launched expansionary fiscal policies to counter the downdraft affecting their economies through the various transmission channels. While in others who were running bigger budget deficits, assistance was sought from the IMF which made quick-disbursing facilities available.

It goes without saying that no country anywhere can be immune to a crisis of such global reach and unprecedented severity. It is a credit to African decision-makers that their countries found their way back to the path of recovery so rapidly.



In addition to prudent macro-economic policies, growth in Africa has also been propped up by timely financial support from other multilateral agencies apart from the IMF. To shield Africa from the second-round effects of the crisis, the African Development Bank spotted the most vulnerable countries and made emergency finance available. During 2009, it more than doubled its lending, from around US$5 billion to US$11 billion. The International Finance Corporation, the private-sector-lending arm of the World Bank Group, increased its loans to firms for private sector projects in Africa which reached around US$2.2 billion in 2011, or more than twice the 2007 pre-crisis level.

The improvement in macroeconomic management in many developing countries, including Africa, followed in the wake of major improvements in governance. These were reflected in more robust democracies and more frequent elections, and accompanied by steps to reduce corruption, end conflicts, and empower women. From the 2011 Mo Ibrahim Index of African Governance, we learn that "27 out of 53 listed countries in Africa have improved in overall governance quality, and just under half have declined". The report notes that the majority of countries had improved in such categories as "Sustainable Economic Opportunity" and "Human Development". In other words, growth has become more equitable, more inclusive, and accompanied by more buy-in from local populations. Thus, better governance feeds into better economic outcomes, shores up resilience against shocks, and helps Africa confound its critics that it is a perpetual underperformer. Development is, of course, an unending struggle and a lot remains to be done. The World Bank's *Ease of Doing Business* report shows that Africa counts *only* 4 countries (Mauritius, South Africa, Rwanda and Tunisia) among the top 50 countries ranked by the ease of doing business.

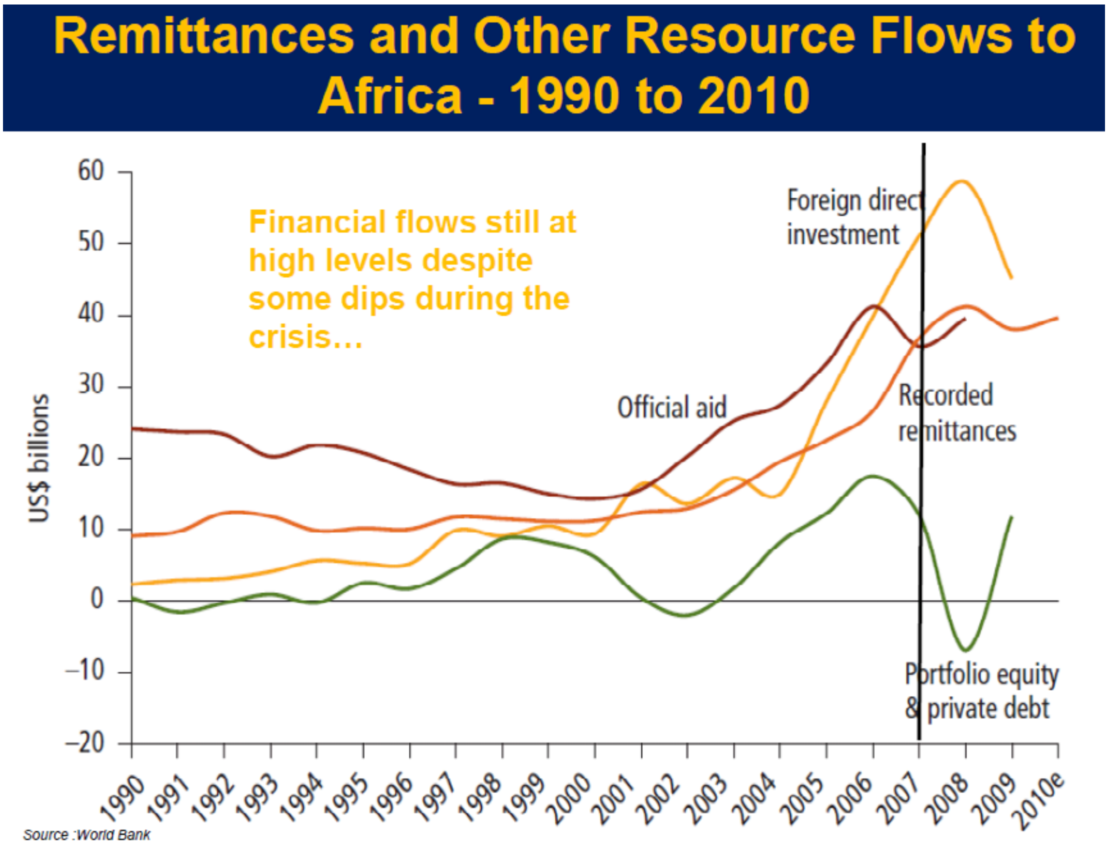
Ease of Doing Business, 2011 Report

Ranking of Selected Economies

Economy	Ease of Doing Business Rank
Singapore	1
Hong Kong SAR, China	2
New Zealand	3
United States	4
Denmark	5
Norway	6
African countries among Top 50	
Mauritius	23
South Africa	35
Rwanda	45
Tunisia	46

Source .Ease of Doing Business, Report 2011

Remittances play an important role in numerous African economies. Africa's diaspora is variously estimated at around 20 to 30 million, mostly in the crisis-hit OECD countries. They send about US$40 billion annually to their families at home. Remittances constitute more than net official ODA in many economies. There was, thus, a tremendous fissile potential in both these channels and we, in Africa, can count ourselves lucky that they have not been put to the test, at least so far.

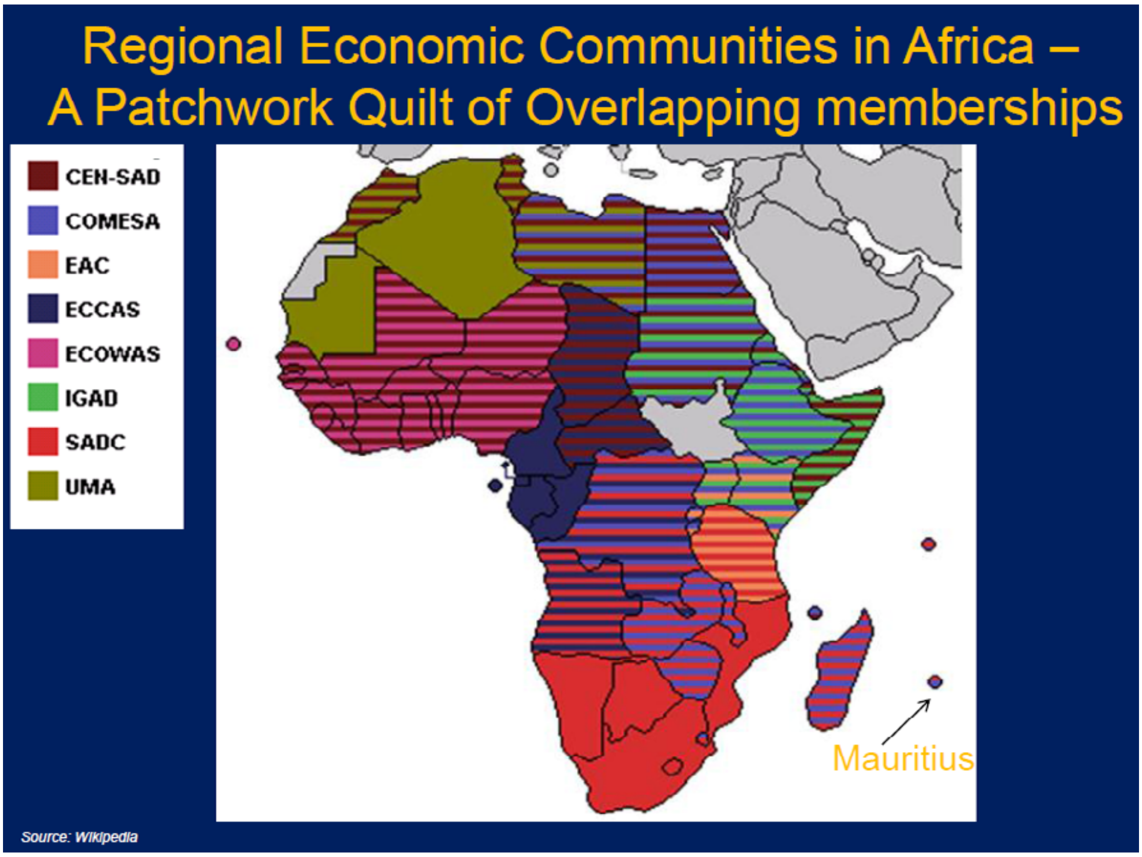


However, we need to be wary that a continued slowdown in the West could cut demand for African exports of goods and services and curb private finance flows. Hence the need for Africa to look within the continent for greater resource mobilization while, at the same time, accelerating regional integration to safeguard against volatility in finance, employment, output and growth.

Despite its numerous challenges, Africa seems to have emerged so far in a fair state of health. Experience varies but, generally, African economies have logged an impressive growth performance. This year, 2011, several African states rank among the fastest-growing economies in the world. Ghana outshines China and India. Nearly a dozen countries from Angola to Zimbabwe run neck-to-neck with them, outperforming Brazil and Russia. So far, so good, then. But what of the future? What are the prospects? Whither Africa?

How far will the newly emerging element in northen Africa, the “Arab Spring” affect the picture? Will the ‘great leap forward’ acclaimed by Donald Kaberuka, Chairman of the African Development Bank, at the G20 meeting in Paris on 21 October 2011, mean, as he claims, that Africa has “*left behind the stagnation of the past*”? The optimism is grounded in a solid record of achievement. And yet, there is so much in Africa, that could be done better, smarter, and more efficiently.

Take the regional integration agenda, for example. The complex political and economic affiliations of the 54 African states, – organised in an alphabet soup of 6 economic blocs, with many overlapping intra-regional groupings – can lead to wasteful duplication of efforts. The differing goals of these political and economic blocs, their differing timelines, and differing methods of operation can dissipate collective efforts towards the goal of many for African Union. They slow down negotiations for continental level integration. Can this shifting geometry of linkages really ease the overall continental integration process? Or, does it not cry out for simplification?



Africa has undoubted untapped wealth and potential. It is no longer the dark continent! It has 70 per cent of world's production of cocoa; 50 per cent of speciality coffee; 12 per cent of tea; 10 per cent of world reserves of oil; 40 per cent of gold, 64 per cent of manganese, 33 per cent of uranium and, nearly 90 per cent of cobalt, chromium and platinum – and it has all this at a time when prices are rising steadily for such commodities, which are crucial to global development. And yet Africa ranks among the world's worst performers in so many categories, including poverty. It is largely unbanked, with poor access to finance for its population. It has inefficient financial institutions and poor institutions generally. It is generally trailing behind at bottom of the pile in education and health but, sadly, it tops the charts in illiteracy and epidemic disease.

Let me address another challenge that the Continent faces: offshore farming. This is the growing phenomenon of international farm investment, in which countries short of productive agricultural land, but rich in capital and agricultural technology, are acquiring farmland overseas for large-scale agriculture. This may have been given a boost by the commodities boom and the weather-related surge in food prices which occurred during the crisis when some food-exporters applied export bans to keep domestic prices low, raising food security concerns in nervous importing countries, including ourselves here in Mauritius.

The phenomenon rapidly assumed the dimensions of a global land rush, driven by sovereign wealth funds and multinational corporations on the back of bilateral state-to-state deals which raise the spectre of neo-colonial exploitation. China, South Korea and OPEC's Middle East members, which face an explosive situation as they have more oil than irrigation water, are the most prolific deal makers. They have come to be seen by some as the neo-colonisers, taking over from the former colonial powers who are now in retreat. As before, Africa with its untapped agro-ecological potential, is a choice target for such investment.

The Food and Agriculture Organisation reports that 2.5 million hectares have been acquired since 2004 in five African countries alone which rank among the world's poorest states, and have some of the highest levels of poverty and malnutrition. That's an area almost the size of Belgium. If the analogy with Belgium suggests itself here, it is no accident: as some of you will recall, King Leopold, the King of the Belgians, joined the scramble for Africa by laying claim to the Congo basin as his private fiefdom. Farmland worth US$20 billion-US$30 billion has been quietly handed over on lease to Saudi Arabia, Kuwait and China for growing staple crops or biofuels, and shipping them home. The big question is what are the starving people in these African countries getting from such deals: if the deals are so good, why did the people in Madagascar throw out the government that signed one of these mega-deals?

We should perhaps not be surprised by the findings of a recent (October 2011) IMF study on the matter. It comes to the startling conclusion that the investment climate of the host country actually weighs very little. What matter much more are poor governance and lack of transparency. This turns the conventional policy prescription on its head! Weak land governance and poor security of tenure for current users seem to enhance the attractiveness of countries for offshore farming. These perverse incentives need to be addressed if offshore farming is to lead to win-win outcomes for both home and host countries. Otherwise, they can rapidly erode hard-won gains in democracy, governance and transparency.

With the ongoing troubles in the US and Europe, current global growth depends much more on growth in demand from developing countries and emerging markets. There is growing consensus that it will be quite some time before the tide turns for the better in Europe and the US. The euro may not actually be in its death throes as some doomsters have been predicting. But it is clear that the latest definitive solution to the Eurozone sovereign debt crisis is no more definitive than the half dozen or so that preceded it. The euro saga keeps rolling on, along with the debt rollover that threatens to sink the currency and the Eurozone economies. Many at the European Commission and at the European Central Bank must be kicking themselves for not paying heed to the ancient Roman adage: "*Timeo Danaos atque dona ferentes!*" For "*dona*", read "*referenda*"! Beware of the Greeks! Or have I got it the other way round? It's the Europeans and their partners who have come bearing gifts, a cool Euros 130 billion in the latest sovereign debt bailout. Beware of the Europeans, say the Greeks, looking this gift horse in the month.

If the euro has its troubles, so does the dollar with "helicopter Ben" at the controls of the red-hot printing press. The US dollar remains the world's reserve currency but confidence has been shaken by the fiscal brinkmanship in the US and the downgrade of its sovereign rating. The economy is doing poorly and there is little hope of any significant improvement in the near future.

Against this gloomy backdrop, the only real glimmers of hope come from Africa's non-traditional partners, the rising stars in the East, China and India. African policymakers do not need to subscribe wholeheartedly to the short-lived "decoupling" theory to seek to reduce their former dependence on OECD markets. Traditional patterns of trade and investment are changing. China has overtaken the US as Africa's largest trading partner. Trade between Africa and India increased tenfold from 1997 to 2007, when it stood at US$ 70 billion. And trade between Latin America and Africa has more than doubled since 1994 and now exceeds US$26 billion. Our own trade exchanges with Chindia followed a similar trend. Mauritian imports from these two countries saw their percentage share in total imports more than double, rising from 16 per cent in 2000 to 36 per cent in 2010. Exports to Chindia, although still a trickle, quadrupled their percentage share.

As the Western economies lost momentum and FDI outflows fell off, China and India readily picked up the slack. Businesses in emerging markets are doing particularly well from this. We read in the Indian press headlines such as *Billionaires Go on Buying Spree in Africa*. We learn they are investing in some 80 ventures in Africa, the new girl in town, winning every beauty contest. China is the largest investor in Africa. China and India are not being charitable. It is an open secret that returns on FDI in Africa are among the most attractive around.

This expansion and diversification in investment and trade has brought notable improvements in additional know-how, technology and development experience from these emerging economies into the African continent. The crisis spurred this shift away from the advanced countries toward the East [China and India] and the South [Brazil and South Africa] for Africa and is transforming the gearing of the global financial and economic system.

Africa is certainly not sinking into any depth of despondency, bewailing its lot that it has been let down by its traditional partners. It is alive and kicking. In this time of African renaissance and renewal, we should learn some lessons from the recent Greek sovereign debt crisis and default threat. There is a glaring difference in the way Greece is being treated and the treatment meted out to African countries when they faced a fairly similar debt predicament. The speed with which decisions are taken, funds made available, haircuts agreed with bankers and creditors, and the personal engagement of the high and mighty, all stand in sharp contrast to the slow and lumbering processes of the Heavily Indebted Poor Countries mechanism. HIPC came with its own jargon of "completion point" and "decision point". It proceeded at a glacial pace. It was an obstacle course where strict performance criteria had first to be met before qualifying for any debt relief.

The scheme started in 1996 and by July 2011, that is a full 15 years later, of the 40 countries eligible for the HIPC Initiative, only 32 had reached the so-called "completion point". Twenty-six of these countries are African. If all 40 potentially eligible countries reach completion point, total debt relief provided by the World Bank and all participating creditors is estimated to reach around US$142 billion. As HIPC critics contend, it was a case of too little, too late, for too few countries.

Contrast this with the case of Greece. In May 2010, the IMF approved a €30 billion three-year loan for Greece as part of a joint European Union-IMF €110 billion financing package to help the country ride out its debt crisis with about €5.5 billion immediately available. A haircut of 20 per cent was agreed without much ado, and raised with little difficulty to 50 per cent within weeks. And there will probably be still more support forthcoming for Greece, if only out of enlightened self-interest to forestall any contagion to the other vulnerable Eurozone economies. This differential treatment becomes still more glaring when we take into account the population affected: just over 11 million for Greece, as against 462 million for the African HIPC's. One cannot escape the conclusion that the donor community had been pulling its punches with HIPC and could have done far more for the countries concerned.

Well done Greece: hard cheese Africa! So, there should be more reliance on self-help in the future. Over the past decades, the financial sector in Africa has slowly begun to realize its potential to mobilize domestic resources and finance African growth. Across the continent, there are numerous examples of finance firmly serving as a catalyst to transform African economies. It is increasingly providing capital and credit to new businesses, or supporting the expansion of productive capacity in established firms. Cheap and rapid transfer channels for remittances dot the continent. SafariCom, in Kenya, has harnessed mobile telephony to deliver a range of services to meet previously unmet needs and stimulate growth. These include new products such as weather insurance to help farmers manage climate risks, equipment leasing to help small enterprises, and acceptance of warehouse receipts as security to push financing into agricultural value-chains. It enables low-income households to manage their lives more effectively through mobile payments, microcredit, no-frills accounts, and micro-health insurance. These developments are key transmission channels for growth and development.

Long-term finance is crucial for Africa's development for equipment leases especially for farmers, for investment in essential infrastructure such as power and roads, and to upgrade the housing stock. But getting banks to go in this direction remains a challenge across Africa. By international standards, African banking remains expensive and poorly adapted to local needs.

African banks are starting to respond to the demand. During the crisis, some international banks turned out to be fair-weather friends, downsizing, retrenching, or even closing when African economies were at their most vulnerable. Others, based in international money centres, withdrew or reduced trade lines. Local banks, including central banks assuming their developmental role, stepped smartly into the breach. Although African banks are small, 40 of them made it in the Top 1000 World Banks in 2011. They are also among the world's most profitable, according to a survey by *The Banker*, which supports the contention that Africa is a land of high returns. Of those who had not made it to the top 1000 banks, we find many African banks lining up to join their ranks. Of the top 10 global lenders in this next group of 1000, measured by return on capital (ROC), five are African. Of the top 10 with the highest return on assets (ROA), seven are African. Overall, African banks – there are 17 in this survey – made average ROA's of 3.65 per cent [on an unweighted basis] and ROC's of 35 per cent. These levels are far higher than the next profitable region, namely, South America, where banks made returns of 1.95 per cent on their assets and 19.6 per cent on their capital.

The investment needs of Africa are huge. Africa has to grow and explore other ways of attracting finance and capital. There is ample room for public-private partnership initiatives in the continent and the concept has to be vulgarised. What is vital for the future is that business in Africa gives greater weight to quality, inclusiveness and equity, or the aftershocks from the Arab Spring will spread across the whole continent, feeding on the pent-up grievances and aspirations of local people. Moreover, we must broaden our assessment of progress to include the protection of the environmental capital of the continent in the equation for measuring development, and not zero-value it, as too often in the past. This is essential to ensure that any fresh spurt of economic growth follows a sustainable path and does not end in further land and human degradation.

Let me conclude. When the global economic and financial crisis struck, Africa took a hit like everybody else, although with a lag. As its traditional trade partners teetered on the brink of recession and seemed to make living on the edge their new way of life, lurching from one crisis to another, African growth faltered, falling off from its trend average of 5 per cent annually over a decade. The fall was steeper in the middle-income countries like Mauritius, but growth turned only marginally negative. Governance and policy reforms leveraged financial support from multilateral institutions to deliver a quick rebound in 2010. Africa also made some quick gains in re-orienting its trade and investment towards the rising stars in the East and South. The African investment climate attracts rising volumes of capital flows, both private and official. That's the rosy view.

But there is also a darker side to the picture. The global crisis is continuing, with no end in slight unless you are delusional. Africa is running out of fiscal space as inflation is hitting high double digits in, for example, East Africa. The Eurozone remains the continent's main trading partner and prolonged slowdown in the EU and the US mean demand for exports of goods and services will remain constrained. International commodity prices, which have a determining influence on the economies of so many African countries, are likely to stay weak for quite some time, clouding African prospects. In this globalised, interconnected world, there is no place to hide. If a rising tide lifts all boats, a receding tide can play absolute havoc.

On balance, weighing these two contrasting narratives, what can we say? Whither Africa? I think the African growth story will continue. Africa has built up a certain resilience and there is little reason to believe this will diminish. The dynamism that characterises the African policy space, with many countries being very pro-active, gives ground for optimism. However the global crisis plays out, Africa is not likely to shoot itself in the foot. For a concluding remark, let me draw on a recent World Bank publication on Africa's future (March 2011) which encapsulates it nicely:

“Putting these factors together, the Bank concludes that Africa could be on the brink of an economic take-off, much like China was 30 years ago, and India 20 years ago.”

Whither Africa, you ask? Poised for an economic take-off, no less!