Speech by Paul Collier on 11 May 2013

I wanted to start with a word about the late Andrew Crockett, who was, of course, the General Manager of the BIS. I attended his memorial service, where he was eulogised for opening the Bank up to emerging market economies. I know he felt passionately about that. Among his many achievements, he thought that valuable meetings like this one were too infrequent. So the BIS founded a roundtable which meets each year to discuss issues relevant to African economies.

Now what I want to say is that Africa has distinctive characteristics and distinctive challenges. And because Africa is different, it will need distinctive solutions. Thus, policymakers should be wary of just picking up global monetary guidelines. Sometimes the guidelines aren't right anyway; before the financial crisis they were obviously not even right for the countries that faced these crises. Now the guidelines are being adopted by African countries that didn't face that type of crisis. So, the African central banks need to do quite a lot of their own thinking as part of this.

The next distinctive feature about Africa is that central banks are a much more important source of economic information than the typical central bank, like the Bank of England in my country. The Bank of England is one voice of economic information for citizens and government but it's only one voice. There are many other authoritative voices. But in Africa central banks loom very much larger, and so the job of communication is much more important. Building the capacity to communicate is enormously important. In a democracy the central bank needs to build a critical mass of informed citizens. The Bank of England routinely publishes an inflation report and the minutes of its monetary policy meeting. That's just one of the many things that it does in seeking to keep citizens and the government informed, and so I urge central banks to recognise that distinctive responsibility and role that they have.

Let me say a few words about what's coming down the pike; what I think the next decade will hold. There is a saying that you should never listen to economists making forecasts. But I'm going to forecast two things. One is that the 2010s will be a decade of African growth. The last decade was a decade of resource discoveries and those discoveries will be coming on-stream in the next decade; gas in Mozambique and Tanzania, and oil in Kenya and Uganda. Around the continent, the rate of growth is going to be higher than it has been in most of the past. This has important implications for the financial sector. When economies are stagnant they don't actually need a financial sector because firms can pretty well self-finance from retained earnings. Once the economy starts to grow, firms need finance. They need more money for working capital because last year's sales won't pay for next year's inputs. And they need to invest. So, whole classes of financial activity are missing in an economy that's had a long period of stagnation. The financial sector needs to grow much more rapidly than the growth of the economy. You need a bigger financial sector relative to the economy. And so you need to gear up.

To finance a lot of investment by small and medium firms is going to be risky. So Africa will need a class of financial actors accustomed to risky investment: venture capital. It's ironic that today you find plenty of venture capital in Britain and America, which have less need for it. In Africa there are precious few venture capital financial firms at the moment. So, it is important for African central banks to try to build that sector beyond the commercial banks. The banks don't have the skills or appetite to do that sort of risky lending.

Related to this, households as well as firms will wish to invest more. Housing is the most obvious thing that households invest in. At present, Africa has an amazingly small financial sector for housing. Mortgages serve about 3% of the population. One reason is that central banks haven't fully cracked inflation. So Africa might have to learn to live with inflation rates of around 8–12%. That's perfectly all right for an economy, but it's a disaster for a mortgage market. It forces mortgages to be repaid much too fast, so one thing that central banks might want to think about is learning to live with the problem. If inflation is going to be hovering around 10% for a while, what about indexed mortgages? The only African country I know that does this is Ghana. I talked to the Ghanaian mortgage firms and they said that 80% of their mortgages are indexed. Such indexation has helped Ghana develop a mortgage market of its own. This is just an example of what Africa can do to live with moderate inflation, rather than try achieving inflation target of 2%, which is a typical norm in advanced economies.

The other prediction I wish to make is that, in future, Africa may have to live with greater degree of macroeconomic volatility. This follows from the fact that Africa is going to be more dependent on natural resource exports. Prices for natural resource exports will be somewhat lower than the heady levels they reached during the peak of the supercycle. This means that the rents on natural resources will fall much more than the actual prices of those resources. And as prices wobble around, those rents will become more volatile; and rents are what the government captures as revenue. Learning to live with government revenue volatility implies the need for institutions that smooth public spending. The agent that should be managing this is the central bank, in terms of both advising on what rules should be established and actually running the process. It might be a stabilisation fund, or just better hedging. Again, Ghana is an interesting example of a country that has been quite successful in hedging revenue volatility by locking the budget into a base of commodity prices.

Let me now focus on a few received wisdoms. One is inflation targeting. There's a lot to be said for inflation targeting but there are also a couple of negatives. Indeed, on the whole now, central banks are moving away from inflation targeting as the only act. For the typical African country, the real exchange rate matters as well as the rate of inflation. Within inflation, it's not clear what things central banks should target. If central banks leave food and fuel out – as has been the case in many IT regimes – because these are volatile, they lose what matters to ordinary people. The central bank is targeting something that does not relate well to the lives of ordinary people.

The same applies to asset bubbles. I suspect that Africa is not immune to such bubbles and that its central banks may have to cope with rather more of them over the next decade. I remember being at a Bank of England seminar in 2007. I tried to raise the issue of asset bubbles and the response was: "Oh you can never tell when an asset bubble is forming; we just ignore them." One no longer hears things like this. So that was an example of a mantra that became a guiding ideology, yet was just plain wrong. You can't afford to allow the fluctuating enthusiasms of foreign investors to send capital washing in and out of Africa and blow up property bubbles all the time. There needs to be some way of dampening the exuberance.

The other received wisdom we've already touched upon relates to monetary union. I want to contrast this sort of idealistic goal with the practical problem of achieving economic integration. There's a lot that central banks can do here. African countries could think about holding each other's monetary instruments. We talked this afternoon about central banks issuing monetary instruments and the need to develop deeper bond markets. Well, if central banks could actually hold each other's liabilities, that would be a real example of central bank cooperation. I think it should be done carefully because holding dollars, euros and yen as reserves implies exposure to significant future losses. To give an example, the portfolios of North American universities, which are managed by smart people, have all massively moved out of US government bonds following the recent global crisis. So you're in danger of holding a lot of loss-making assets.

Finally, let me mention something about foreign aid flows to Africa from my latest book, "The Plundered Planet". I suggested to the British prime minister, who is hosting the forthcoming G8 meeting, that, rather than promising to double aid to Africa, the G8 should try to put its own house in order in ways that are helpful to Africa. The focus should be on reducing corporate tax avoidance and money laundering, cleaning up and clarifying issues of beneficial ownership, and enhancing transparency in the extractive industries. Those are the big three challenges. There's also a fourth one; that is, trying to get western pension funds and other investors to invest in the bonds and equity of African utilities. The huge amount of money in European and North American portfolios, which at the margin is earning practically nothing at the moment, could finance some of the scale-up in infrastructure that Africa really needs.