Jens Weidmann: Improving the investment climate in Africa – the role of institutions

Keynote address by Dr Jens Weidmann, President of the Deutsche Bundesbank and Chairman of the Board of Directors of the Bank for International Settlements, at the G20 Conference "G20 Africa Partnership – Investing in a Common Future", Berlin, 13 June 2017.

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It is a great pleasure for me to open the second day of the Conference "G20 Africa Partnership – Investing in a Common Future". This two-day conference is the third G20 conference of the German presidency in the Finance Track.

We kicked off the German presidency with a conference here in Berlin. The aim was to discuss how to best make the global economy more resilient. The second conference, which was about the digitisation of finance, took place in Wiesbaden. We addressed both the opportunities and the challenges surrounding the digitisation of finance.

Now we are back in Berlin to push on with the third key priority of the Finance Track agenda: the "Compact with Africa" initiative. The initiative aims to help African countries mobilise private investment in general and infrastructure investment in particular.

These three priorities of the German presidency were not chosen at random. They express an ambition and a conviction: the ambition to shape globalisation in our mutual interest, and the conviction that it is possible to do so. The relationship between Africa and the G20 is a case in example.

Africa stands ready to benefit from an open world economy. Its economic outlook is positive. Between 2009 and 2014, the average growth rate was about 4 %. Since then, low commodity prices have slowed the pace of growth somewhat. But medium-term growth prospects remain solid.

That's true, at least, when looking at total growth rates. But what really matters when seeking to improve welfare is per capita growth. Here the picture is less benign. Africa's population is growing fast. Today, it is home to 1.2 billion people, and the United Nations expects the population to double by the year 2050. And although the economy is growing faster than the population, it is doing so only slightly. Because higher output has to be shared with ever more people, the World Bank expects income per capita growth to lag behind total growth substantially.

Africa's young and growing population can be a boon or a bane. The demands of the young population are growing by the day, in part due to the increased use of mobile phones and social media. In an unfavourable economic and political environment, this can lead to frustration, conflict and a high willingness to emigrate. But in a favourable environment, the young population can help achieve a demographic dividend. In that case, Africa would also strengthen the global economy.

But creating enough jobs to absorb the new workers requires investment. The World Bank estimates that investment in the African countries needs to reach one-quarter of gross domestic product to achieve sustainable and inclusive growth. Over the past 15 years, the average was only one-fifth of GDP. So there is still some way to go.

At the same time, in other regions in the world, the forces of demography are almost the opposite. In Europe, the population is generally older and what is more is expected to shrink. Germany is a prime example of this. The medium age of our population is only exceeded by Japan.

These demographic trends are already burdening the long-term economic outlook of Western economies today. And it might also reduce the return on investment in these countries.

At the same time, people are looking for ways to channel their retirement savings into reliable and profitable investments. And they are doing so not only at the domestic level, but are in general also open to investing these funds abroad.

This is where the “Compact with Africa” initiative comes in. It seeks to mobilise private investment – infrastructure investment in particular – in Africa.

But those funds for investment do not necessarily have to come from abroad. I’m sure many Africans are looking for safe and profitable investment opportunities too.

You may have noticed that you are sitting in what was once such an infrastructure investment. The gasometer in the Schöneberg district of Berlin is an early-20th century industrial site. When it was constructed in 1908, it was one of the three largest gas holders in Europe. Gasometers were built for factories in the Industrial Revolution as a light source and for industrial processes that required gas.

This particular gasometer, and many others like it, became redundant as we turned to other sources for lighting. But to this day, it is a reminder that an efficient energy infrastructure is an important precondition for private investment and growth.

Infrastructure is the backbone around which private sector activities can flourish. Transport and energy services are essential arteries through which the lifeblood of an economy flows to the veins of the private sector.

After all, what good is the best crop if the farmer can’t transport it to the market? And what good is the best engineered car if it can’t be shipped to the customer?

An economist would put it like this. A functioning infrastructure – the safe supply of electricity, access to roads, railways or the sea – raises the return of private investment.[1]

So investment in infrastructure can start a virtuous cycle: when adequate infrastructure raises income and productivity, it becomes easier to mobilise the financial resources for investment in general and infrastructure investment in particular.

But unfortunately, the chain of causation can also go the other way round. Barry Eichengreen has pointed out that countries can find themselves in a low-level equilibrium trap in which the lack of infrastructure limits finance and the lack of finance limits infrastructure.[2]

By the time this gasometer was built, Germany – and other Western countries – had managed to avoid this trap: partly because they developed strong institutions and an effective administration; they protected private property rights as well as capital markets and banking systems; moreover the rule of law prevailed. All these factors helped in mobilising financial resources to fund infrastructure projects.

This shows that the conditions to mobilise investment can to a large extent be created by the individual countries themselves. This is why the “Compact with Africa” stresses the need to put in place a stable macroeconomic environment, reliable legal systems and appropriate regulatory and supervisory frameworks. These are the three building blocks of the “Compact with Africa” initiative. They go under the headlines (i) Macroeconomic Framework, (ii) Business Framework and (iii) Financing Framework. You will have the opportunity to discuss these three topics during the two Breakout Sessions this morning and this afternoon.

But in the end, when it comes to improving macroeconomic stability and to establishing reliable legal systems as well as sound regulatory frameworks, there is no one-size-fits-all solution. Each country has to tailor these general orientations according to its own individual needs. This task cannot be outsourced to someone else.

That is why it is called the Compact with Africa, not for Africa. The guiding principle is that our African partner countries are in the driver's seat. And they don't have to begin from scratch. We know at the Bundesbank from our technical central bank cooperation that the level of expertise is often quite impressive.

In the past years, the Bundesbank has conducted seminars with central bankers from 13 African countries. Only in May this year, together with the Bank of Morocco, we organised a conference on "good governance" in Rabat. Participants came from ten different central banks in the French-speaking part of Africa. And together with the Federal Financial Supervision Authority of Germany, we are planning a seminar on "capital market development" in Rwanda.

Domestic debt markets are the primary way to raise private funds for investment. And they are even more helpful when they raise capital in local currency because no exchange rate variations put the investment decisions at risk. The existence of such a local currency bond market also underscores the credibility of the domestic currency.

So far, relatively developed local currency bond markets in Africa exist in South Africa, Egypt and Nigeria. Together, they account for nearly 90 % of total outstanding local currency bonds in Africa.[3]

I'm convinced that other African countries could benefit from the experience of these three countries. In South Africa, for example, the domestic bond market developed as far back as the 1980s, when the country had to look inwards to finance fiscal deficits.[4] Nowadays, the South African market is well integrated into international financial markets, and has successfully funded infrastructure to upgrade ports, railways and public utilities such as the power grid.

And local currency debt markets also have another advantage. My colleague, Governor Lesetja Kganyago, has once pointed out "In South Africa, the existence of a large and liquid domestic government bond market […] has limited the rise in foreign-currency denominated debt, even as our country has experienced large current account deficits."

Today, digital technologies can help develop domestic debt markets. And digital technologies can be key drivers of financial inclusion in less developed countries.

In Kenya, for example, the share of people with a financial account rose from 42 % in 2011 to 75 % in 2014. Over the same period, the respective global figure rose from 51 % to 61 %.

In tandem with the mounting ubiquity of cell phones, mobile money accounts have gained popularity, particularly in Sub-Saharan Africa.

In some countries, there are even more adults with a mobile money account than a conventional bank account.[5]

So when it comes to digitisation in finance, there may be something the G20 can learn from Africa, too.

In any case, "Compact with Africa" signals that African countries are not alone. A compact has at least two signatories. The G20, other partner countries as well as international organisations like the African Development Bank, the IMF and the World Bank are offering their support with regard to implementing reforms. Partner countries can also set up technical assistance, support early-stage project development and encourage their business sectors to invest in compact countries.

The G20 will act as a platform to give African countries the opportunity to make their reform efforts known, and to help them find potential investors. Today's Investor Roundtable is the first opportunity to do so.

So in a way, the "Compact with Africa" acts like an amplifier: African countries participating in the compact send out a signal that they want to mobilise investment and are willing to undertake the necessary reforms. The G20 amplifies this signal, making it more audible and more credible.

Yesterday, we heard from many G20 member states and guests that they want to support the countries that have already signed a compact. There was broad agreement that coordinated, comprehensive and country-specific measures have the best chance of attracting private investment. And the International Financial Institutions stated their strong commitment to pursue this initiative further. The incoming Argentinian presidency will also ensure continuity after the German presidency ends.

But today marks the beginning of putting ideas into practice.

It is often said that it took the West 300 years to innovate and industrialise, Japan less than 100 years and the East Asian "tigers" only 40 years. Maybe Africa can break the record again.

Certainly, I won't delay an attempt to do so any longer.

I wish you all a very successful second conference day and inspiring discussions.

Thank you.

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1 As mentioned by Paul Collier, it is not the rate of investment but the return on investment that matters; P Collier (2007), The Bottom Billion, Oxford University Press, p 44.

2 B Eichengreen (1994), Financing infrastructure in developing countries: lessons from the Railway Age, Policy, Research working paper no WPS 1379, Washington, DC, World Bank.

3 A figure of 88 percent is mentioned in the joint AfDB, IMF and WBG Report G-20 Compact with Africa.

4 At that time, South Africa was under international pressure from the anti-apartheid movement and was the target of financial sanctions.

5 A Demirguc-Kunt et al (2015), The global findex database 2014: measuring financial inclusion around the world, World Bank Group Policy Research Working Paper, No 7255.