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Africa's economic renaissance: development and interdependence

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Good evening ladies and gentlemen. Thank you for inviting me to address you this evening, at this place of learning that has contributed so decisively to the struggle against apartheid.

Education is about discovery and self-development. The creation and transfer of knowledge is the basis on which our people and our societies grow. It is both the basis and fruit of our human emancipation, and deserves therefore all the protection and nurturing our societies can provide. But education has responsibilities as well, and one of them is to ensure that we identify and qualify the statements of what we know, do not know, and cannot know.

In the field of economic policy, the realism and clarity that ensues from that identification process is particularly difficult to achieve. Even the best statistics are only comprehensible through the medium of models – themselves necessarily simplified distortions of our complicated ‘real’ world.

For all of us, governments, civil society, firms, unions and the academic community, the ambiguities of the real world and our need to represent it in intellectual constructs opens up endless scope for subjective interpretation and argument. But to even this there must be a limit, and our development of knowledge, no matter how flawed, helps to identify those limits and frame the decisions needed to progress the project of human emancipation through development.

For Africa, the application of knowledge to decision making is no less complex than in other regions of the world. Our history has set out many obstacles to overcome.

Africa’s initial challenge is to achieve economic development, which I define simply as the sustained increase in income of all members of society so as to be free from material want. One aspect of that challenge is to achieve development in an interdependent world. That is a world in which goods, services, people, capital and knowledge flow relatively easily across national borders with large net benefits to economies.

African development can and will benefit from economic and political interdependence with the developed world, other emerging markets, and other developing regions. Interdependence can be a trigger for Africa’s development. Positive outcomes from interdependence, however, are contingent on how we define the current state of dependence – and how we implement the domestic and international policies that enable us to move from dependence to interdependence.

Defining dependence as a constraint to development

In the postwar era, Latin America, Africa and Asia, in varying degrees, embarked on a road to democratic institutions and market-driven, state-assisted economic development. With an overly large number of exceptions, most have progressed. Our global environment is not benign, despite considerable effort that has been applied to reduce its worst effects.

We have set ourselves a global metric for improving the living conditions of our people called the Millennium Development Goals (MDGs). It is a route to economic development and rising living standards in an interdependent world. The MDGs provide many intermediate and final objectives, and few specific means of achieving them.

The Monterrey Consensus, alternatively, provides recommendations on how to achieve the MDGs. For Africa, the New Partnership for Africa's Development (NEPAD) further specifies actions, institutions and policies at the regional level. At the national level, Poverty Reduction Strategy Papers (PRSPs), Medium Term Expenditure Frameworks (MTEFs) and other national plans provide the focus for domestic action by governments and states.

At each level, global, regional and national, however, the will and means to implement these programmes are not always evident. One reason for our implementation problem is that economic development is heterodox – it happens in different ways in different countries and regions of the world. At the same time, at national and regional levels, obstacles exist that lie outside the competence of the MDGs or Monterrey to define adequately. Some countries for instance remain weighed down by the political legacy of colonialism, which affects the ability of our societies to agree to the basis on which peaceful social and individual interaction will occur.

Such legacies also continue to influence our economic development and define Africa's dependence and underdevelopment.

Economic development demands some fairly basic prerequisites, among them macroeconomic stability, a solid expectation of benefits from investment and innovation, and political stability. A fourth has been defined by Dani Rodrik as “the *desire* to integrate in the world economy,” primarily exhibited by attracting foreign direct investment and exporting goods. Perhaps more importantly, such goals need to be pursued by states *capable* of achieving them, which also means being able to decide if specific policy A is a more appropriate, efficient or simply easier route than specific policy B. [1]

To this day, infrastructure networks service colonial-era trading relationships rather than the needs of diversified industries catering primarily to domestic markets. In addition to the need for economic diversification, Africa’s economies must expand financial, health and education services beyond a narrow circle of elites – average government expenditure in Africa is 25 percent of GDP – roughly half that of developed economies. Public financial management systems need to be developed, alongside revenue administration and effective public service delivery. At the basis of such efforts should be some form of social contract that enables individuals and diverse social groups to say ‘this is my government and my state,’ and which facilitates the holding of governments and public officials to account.

The state has an active role to play in each of those elements of economic development. But to be able to fulfill that role, African states need to radically increase their capacity -- weaknesses that can be overcome through extensive and intensive capacity building and technical assistance.

Our dependence can also be seen in other ways.

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[1] **Dani Rodrik, “Rethinking economic growth in developing countries,” Harvard University, October 2004.**

Few developing countries can borrow in their own currencies.[2] The foreign currency denomination of their debt is affected by policy in the issuing country. Total external debt in Sub-Saharan Africa, excluding South Africa, is estimated to be $186,7 billion with the gross geographic product of the same area is about $217 billion. So, assuming US dollar debt, as the US dollar depreciates and appreciates, the cost of servicing dollar-denominated debt fluctuates in the developing country.

In the event of a currency crisis, interest payments in foreign currency rise, causing deeper recessions. Estimates by Hausmann and Rigobon show that after shocks, debt to GDP ratios in a large sample of developing countries have risen 10-20 percent higher than would have been the case with debt denominated in local currency.[3]

One way of dealing with this was the Argentine approach of using a currency board, but this meant, as with any fixed exchange rate regime, that Argentina was adopting US monetary policy. In the 1990s, US dollar appreciation from massive and sustained capital inflows enabled the US to keep interest rates low, but reduced exports from Argentina. High productivity growth in the US kept the economy growing, but the same could not be said for countries with dollar-debt. Slower growth in exports and lower productivity meant that those countries' service costs rose, and when growth slowed their debt and macroeconomic policies became less sustainable or, in fact, unsustainable.[4]

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[2] **Barry Eichengreen and Ricardo Hausmann have termed this "original sin." See for instance Eichengreen and Hausmann, "Original Sin: The Road to Redemption," October 2003.**

[3] **Ricardo Hausmann and Roberto Rigobon, "IDA in UF: On the benefits of changing the currency denomination of concessional lending to low-income countries," draft paper.**

[4] **So long as it is not offset by lower inflation, lower productivity growth in one country in a fixed exchange rate regime results in a real appreciation of that country's exchange rate, reduced competitiveness and lower profitability.**

At the same time, any attempt to improve export growth through real depreciation of the exchange rate when one has foreign currency debt, essentially lowering domestic costs relative to ones trading partners, causes debt to rise and the ability to service it deteriorates. A veritable catch-22.

The result is that when you have high foreign currency debt you are severely constrained – both fixing the exchange rate and deliberate depreciation can lead to crisis. All of this is exacerbated by the premiums developing countries are required to pay in order to borrow at all, which for *stable* emerging market borrowers over the past two years have fluctuated between 200 and 500 basis points above the yield on US Treasuries. However, international capital markets are closed to the bulk of African countries with only 3 out of 53 countries having access to capital markets.

Now, consider the problem of African countries that depend on commodity exports, or a small number of exports that constitute the bulk of export earnings. With commodity prices declining over several decades, many developing countries don't even need to incur more foreign currency debt to become unsustainable – the trend decline in commodity prices does it for them at any given level of debt.

Abrupt short-term swings in prices can prove to be especially damaging. Oxfam reports that coffee prices fell by 50 percent in three years, ostensibly due to an oversupply of 8 percent relative to world demand.[5] In countries dependent on commodities like Uganda, these shifts in prices destroy overnight their ability to service foreign currency debt. Burundi depends on coffee for about 80 percent of their total export revenue. With coffee prices falling by 50 percent, Burundi's total export revenue declines by 40 percent.

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[5] **Oxfam, *Mugged: Poverty in your coffee cup*.**

In the case of coffee, market structures have restricted value flowing back to producers – thereby reinforcing the deterioration in their ability to service foreign currency debt. Coffee retailers have maintained their profit margins by raising prices – which reduces growth in demand relative to supply. Coffee farmers in developing countries receive 18 percent of the final retail price, down from 64 percent in 1984.[6] Ugandan growers receive 2.5 percent of the final retail price of coffee sold in the United Kingdom.

Macroeconomic management has improved greatly across the developing world. Average inflation rates are low. In Sub-Saharan Africa, inflation is expected to average 10.1 percent in 2004, with the high inflation rate countries the exception rather than the rule.[7] Excluding Zimbabwe, Angola, Mauritius, Mozambique and Zambia, today's average country in the Southern African Development Community (SADC) has an inflation rate about 5 percent, has GDP growth of over 3 percent per year, and small fiscal deficits – the average for Sub-Saharan Africa for 2004 is expected to be 2,3 percent excluding grants.

Those macroeconomic results are considerably better than that of the average European economy in the 1920s, 1930s, or 1970s.

The dependence created by the inability of developing countries to raise foreign debt in their own currency could be broken in various ways. Ricardo Hausmann and Roberto Rigobon have suggested that the International Development Association (IDA) lend to

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[6] "Europe and the coffee crisis: a plan for action," OXFAM Briefing Paper 36.

[7] Inflation rates can be grouped: Angola, Zimbabwe have very high rates (56.1, 350%); Mauritius, Zambia, Mozambique, Malawi are high (around 19%); Gambia, Niger, Ghana, Guinea, Sierra Leone and Madagascar are moderate (10-12%), and the remainder, including much of SADC and East Africa, and all of SACU have inflation rates around 5%. IMF, *Sub-Saharan Africa Regional Economic Outlook*, October 2004.

developing countries using an inflation-indexed domestic currency unit of account.[8] This could be created from a basket of developing country currencies in order to spread risk, and would require only a very marginal increase in yields to compensate for the small additional risk. In times of economic stress, debt burdens would not rise, GDP would be less volatile, and overall welfare significantly improved.

As I noted in the example of coffee prices, market structures also need to be addressed. Fair and competitive market structures are as important for efficient international commodity markets as they are for national markets and have public goods aspects to them. It is simply not true that all efforts to liberalize markets, especially markets for internationally traded commodities, will inevitably lead to more transparent pricing reflecting the balance of supply and demand. As states and regulators withdraw from commodities markets, other actors move in, especially very large corporations and consortia of wholesalers and retailers who are able to structure the market in ways that favor themselves.

In the case of gold, higher prices increase the opportunity cost of holding gold and a number of central banks have recently sold gold, despite the costs imposed on developing country producers. In essence, these gold sales redistribute the costs of holding gold onto producers. Some governments also advocate raising funds for good causes by selling IMF gold holdings, which perpetuates our state of dependence – taking with one hand while giving with the other. A serious approach to raising finance for development or debt relief needs to be in the form of a transfer from rich to poor, not from poor to poor.

[8] **Ricardo Hausmann and Roberto Rigobon, "IDA in UF: On the benefits of changing the currency denomination of concessional lending to low-income countries," draft paper.**

Development and interdependence

The Monterrey Consensus suggested that, as an international community, we had arrived at a basis of partnership. Developing countries were meant to undertake policy and institutional reforms. Developed countries agreed to assist in those efforts and to create an enabling international economic environment.

While efforts to stem the tide and reinvigorate economies in the developing world are helpful, they are also utterly insufficient for the simple reason that far too many of the policies and practices of developed countries weigh against them.

Sadly, the developed country practices of cultural exclusion, economic protection, political manipulation and favouritism in the developing world have not disappeared with the dismantling of the Berlin Wall. On the contrary, they have become subsumed in neutral-sounding processes like donor aid, trade negotiations, and international financial architecture.

Trade policy is perhaps the most obvious problem. What good is so much financial aid from the West if developing countries cannot export agricultural products? Financial aid from developed to developing countries can be understood as a welfare transfer to compensate, but in an environment of weak corporate and economic governance and fragmented donor assistance, it creates dependency.

We need to think seriously about the use of aid by developed economies. Surely, economic gain plays a role in allocation, and much of that can be dressed-up as mutual benefits for recipients and givers of aid. But another component is also clearly a function of strategic interest. How much assistance has gone to South Korea in the last few years as a result of concern about North Korea?

We know that Egypt and Israel are amongst the largest recipients of aid from the US, in part to help maintain relative stability between the two. And while we need to recognize the importance of aid to those peace efforts, it is also important to realize that the world has changed. New conflicts, new sources of poverty, new efforts to marginalize the poor are occurring in other parts of the world – but our development partners focus instead on ensuring debt relief and aid is reallocated to Iraq in a vain attempt to cauterize the wounds of that particular war.

The distribution and systems of distribution of aid needs to change, above all because the overall allocations must increase dramatically just to meet our MDG commitments. Perhaps most importantly, we know that underdevelopment and marginalization breeds conflict – a new allocation of aid should reflect that.

The question of how to finance the MDGs has fuelled numerous high-level discussions, the conference at Monterrey in 2002 being the most significant. Along the way, several worthwhile proposals for providing finance for the MDGs have been made, among them the International Finance Facility and global taxation.

Yet despite the suggestions, the international community has so far failed to even plot a way forward on this issue. Implicit in the Lula/Chirac paper is the idea that different options may need to be chosen, depending on what individual countries are able to sign up to from a legal and/or political perspective. Such a “variable geometry” to international financing may help to resolve the current deadlock on progressing with financing, and could be accommodated within an overall framework of monitoring overseen by the World Bank.

The failure to reach agreement on financing, however, also points to the inadequacy of the current decision-making structures for international economic affairs. Reform is necessary, and in my view, if developing countries had a greater say in the running of these institutions, there would be a much greater sense of ownership. In the long run, this would result in better-designed and more appropriate policies – and, over time, declining financial costs.

Addressing exogenous shocks in a less conservative manner would also lower the long-term costs of development. The African continent in particular is highly vulnerable to shocks, be they a sudden drop in the price of an important export commodity, a drought, or exchange rate devaluation. The frequency and severity of shocks has been growing. For example, a recent Commission for Africa paper points out that 44 African countries have suffered natural disasters in the last 10 years.[9] In addition, 28 African countries are judged to be potentially vulnerable to aid shocks, due to their high aid dependency ratios, and 24 countries are very vulnerable to export shocks, because they depend on only one product for more than 50% of their export revenues. And at least 13 African countries have suffered foreign private capital crises over the past 10 years.

Unfortunately, donors contribute further to the uncertain external environment, with unpredictable delivery of aid. The Bretton Woods Institutions have been much better in that respect, providing on-budget support and multi-year commitments. Much has been said about the importance of donor co-ordination but there seems to be little evidence of this happening on the ground.

Interdependence: trade and regional economic integration

I have suggested that the development of domestic markets is needed in African economies. But it is also true that our economies are small. For that reason, regional and continental integration of markets is critical to market development, growth in nascent industries, and for diversification. Without serious advances in trade integration, Africa's economies will remain at the mercy of destabilizing terms of trade shocks and other asymmetric shocks that set development itself back by decades.

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[9] **Martin and Bargawi (2004). *Protecting Africa Against "Shocks"*, Africa Commission Background Paper.**

We can begin making sense of the current chaos in trade policy in Africa by ensuring that our multilateral trade relationships are sound. Our share of global trade is currently very small. However, the removal of trade-distorting subsidies in the developed world will create significant opportunities for African exports. Many developed countries in particular heavily subsidize agricultural products – precisely the area where some African countries have a comparative advantage.[10] Phytosanitary rules limit our ability to raise income from exports in order to invest in the production techniques that will meet those standards.

Greater transparency of intentions would also be helpful – the EU's request for Africa to divide into groups to negotiate 'economic partnership agreements' (EPAs) does little to help Africa coordinate its trade policies – thereby reinforcing the legacy of our colonial economic relationships.

Ultimately, progress on trade liberalization needs to carry through into the African continent, with rationalization of regional trade blocs and lower tariffs between the blocs.

Simply put, we must identify and establish the regional and continental trade regimes to facilitate our own economic diversification and development. We are progressing toward that goal through the articulation and implementation of NEPAD and the establishment of Regional Economic Communities. These plans and processes are the central effort by Africans to counter the dependence that impedes our economic development by setting out a new basis for a positive form of interdependence.

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[10] ***According to a recent study, reduction of merchandise tariffs by developed countries and middle income countries, along with the decoupling of agricultural support and an end to agricultural export subsidies, would produce additional income for developing countries of nearly $350 billion, and would reduce the number of people living below the extreme poverty line of $1 per day by 61 million by 2015.***

Regional economic integration, as the G20 recently noted, can be an important means of achieving greater gains from trade. In Africa, pursuing that integration through Regional Economic Communities, is a necessity. Such communities will enable us to create and share markets of significant size, standardize our regulation of them and create business certainty and confidence, thereby facilitating investment and spurring industrial and service sector diversification. In sharp distinction from our colonial legacy, infrastructure planning and rollout can then follow and facilitate market development.

Concluding comments

Africa's economies exist in a state of dependence rather than interdependence, which is damaging to Africa and the rest of the world. It limits our growth, increases our fragility, and makes our economies poor trading partners. And while historical legacies play an overly large role in defining our dependence, it is also true that our development partners even today take decisions and impose obstacles to the sorts of reforms needed to help us in our struggle for interdependence.

When we talk about regional economic communities, the Bretton Woods Institutions tell us to forget such ideas and unilaterally liberalize. Yet, Western Countries maintain distorting trade subsidies. African countries are likely to be negatively affected by unilateral trade liberalization.

Financing development too often comes at our own expense. Foreign currency debt and markets structured to reduce prices of our commodities foster dependence by preventing us from using our income to build state capacity, diversify, or provide sufficient social services and infrastructure. Donor aid is designed primarily to benefit the economies of the givers rather than those of the recipients.

Under such circumstances, it should probably not be surprising that Africa's own efforts to develop, including NEPAD and the African Peer Review Mechanism (APRM), are cynically undermined in advanced economies. While we struggle to end dependence, our development partners scorn the very concept of interdependence. The great economic challenges of our day – widespread poverty and global imbalances – are reflections of our unwillingness to use knowledge for its best purposes.

Thank you