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Address by

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Chairperson of the IIF, Mr. Douglas Flint

Deputy MD of IIF, Mr. Hung Tran

Central Bank Governors and Deputy Governors

CEOs and senior managers of banks and other financial institutions

Guests from the African continent,

Ladies and gentlemen

I thank the Institute of International Finance for the opportunity to address the inaugural IIF Africa Financial Summit and congratulate you on convening this summit. Welcome to the southern tip of the African continent!

This summit takes place towards the end of yet another tumultuous year in the economic and political life of the globe.

The European situation shows glimpses of hope in the medium term but still lacks short term decisive action. Potentially, the fiscal cliff awaits us all. The dampening effect of slow or little growth in the developed world still casts a long, negative shadow across the global economy. The more recent drivers of growth - India, China and Brazil - have also been impacted. Lower demand from the east and the west is impacting negatively on the growth in Africa, particularly South Africa.

Financial institutions are still falling foul of regulators and one investigation seems to follow on the heels of the last. The challenges of what Adair Turner, the chairman of the Financial Services Authority describes as, "…still more important than poor supervisory approach were deficient rules, deficient structure, and dangerous culture" still need to be addressed adequately.

Above all, the globe sadly lacks a growth and jobs strategy. Millions remain out of jobs. Youth seem to have little prospect of finding their first work experience, and workers are still being laid off in many parts of the world. Ideas, practices and the vital global cooperation that could help to reignite balanced, strong and sustainable growth are absent – let alone a commitment to a growth trajectory that both creates jobs and reduces the endemic inequality pervading the globe.

High oil prices and susceptibility to supply disruptions in a world of heightened geopolitical tension add to the mix of uncertainty.

There is a long road ahead towards the repair of the global economy from the wreckage of the financial crisis. Many previously held "truths" no longer hold and many countries have resorted to unconventional policies to support growth. Some of these will succeed and some will fail, but there is broadening acceptance that the current circumstances are very far from business as usual.

In contrast to the staccato global recovery and sluggish pace of economic activity in advanced economies, Africa has performed remarkably well. After slowing to 2.8 per cent in 2009, growth in Sub-Saharan Africa has rebounded to 5 per cent –

close to pre-crisis rates of growth. Over the next five years, the IMF projects the region to grow on average by 5.7 per cent a year.

Re-writing the African growth story

Africa's economic development has been shaped by its history of colonialism and exploitation. The Scramble for Africa that took place in the second half of the 19th Century was driven in part by European power dynamics and rivalries, but also economic motives with the hope that Africa's raw materials would feed the industrial revolution.

Daron Acemoglu, Simon Johnson, and James Robinson who have spent time investigating the colonial origins of comparative development argue that "Africa is poorer than the rest of the world not because of pure geographic or cultural factors, but because of worse institutions". The colonisation strategy adopted by Europeans influenced the institutional development across colonies. I quote:

> *"In one extreme, as in the case of the U.S., Australia and New Zealand, they went and settled in the colonies and set-up institutions that enforced the rule of law and encouraged investment. In the other extreme, as in the Congo or the Gold Coast, they set up extractive states with the intention of transferring resources rapidly to the metropole. The slave trade is perhaps the most extreme example of this behaviour."*

Armed with a strategy of exploitation, European powers had little incentive to invest in institutions or in infrastructure in Africa to the detriment of economic progress. The extractive approach to development has shaped Africa's past, but also much of its present.

Nevertheless, Africa's growth story has changed dramatically over the past decade. Political stability, improved economic management, and a sustained period of

relatively high commodity prices have contributed to a marked rise in global investment into Africa.

No longer is Africa labelled the "hopeless continent", as it was by the Economist in May 2000. A minority may still believe in the Africa described in Joseph Conrad's *Heart of Darkness*, where the narrator states his exploration of the Congo "was like travelling back to the earliest beginnings of the world".

For most there is a new optimism, hope and self-confidence in and about Africa and its future. Our continent is viewed as one of the great hopes for the world's collective future. The IMF projects that seven of the world's ten fastest growing countries over the next five years will be from Africa – Ethiopia, Mozambique, Tanzania, Congo, Ghana, Zambia and Nigeria – highlighting the significant investment potential and opportunities available.

The imperative of growth for development

Africa needs investment, growth, and development. Investors need opportunities for reasonable returns. And herein lies the potential for a new symbiotic relationship between Africa and the investors seeking new horizons.

Investment in Africa must be guided by a different approach from the colonial past. The new partnership must be based on a long term commitment to building African institutions, African markets and liberating African innovation. At the same time a profound commitment is required to sustainable development and the uplifting millions out of poverty.

For sustainable inroads to be made into widespread poverty and progress with the MDGs, Africa requires sustained growth and inclusive economic development. Sustaining strong growth is crucial for transforming the continent, raising income levels, diversifying exports, and making Africa more attractive for investors.

Trade, investment and technology in Sub-Saharan Africa

Following the financial crisis, many investors have been assessing risk and opportunity differently.

- UNCTAD's recent *World Investment Report* showed that foreign direct investment (FDI) inflows into Sub-Saharan Africa recovered from US$29.5 billion in 2010 to US$36.9 billion in 2011, a level comparable with the peak in 2008 (US$37.3 billion).
- Oil and gas producing countries emerge as major recipients of inward investment. Nigeria, South Africa, Ghana, Congo, Mozambique and Zambia were the six largest recipients of FDI inflows in Sub-Sahara Africa in 2011.
- Many African economies are performing above expectations according to UNCTAD's FDI attractiveness and potential indices.
- South Africa makes an important contribution to foreign investment into the region. South Africa's stock of outward FDI in Africa rose from US$3 billion in 2005 to almost US$17 billion in 2010, focused on natural resources in Southern and Eastern Africa, along with telecommunications, finance, retail and construction.
- The benefits from foreign direct investment are manifold, including an important source of foreign exchange, investment and the transfer of technology and skills. UNCTAD data shows FDI makes an important economic contribution to Sub-Saharan Africa, accounting for 22 per cent of value added, 22 per cent of wages and salaries, 37 per cent of research and development, and 18 per cent of capital expenditure.

The growth of Africa's consumer market is an opportunity too big to ignore:

- Africa is the world's second-most-populous continent with more than one billion inhabitants, of whom more than half are aged between 15 and 65.

- Since 2000, consumer spending in Sub-Saharan Africa has grown at a robust rate of 4 per cent per annum, reaching nearly US$600 billion in 2010 and is projected to reach US$1 trillion by 2020.
- Poverty rates are declining and income per capita levels are rising. As the Economist noted, sixty million African households are now officially middle-class. By 2015, that number is expected to reach a hundred million.

From a trade perspective, Sub-Saharan Africa's share in world exports almost doubled between 2000 and 2010. In part this reflects the resource-intensive growth trajectories of rapidly growing Brazil, Russia, India and China, and other emerging markets. By 2015, Brazil, Russia, India and China are expected to account for almost a quarter of global GDP, up from just 8 per cent in 2000. This should provide expanded opportunities for South-South investment and trade. In 2010, trade between China and Sub-Saharan Africa amounted to more than US$79 billion up from US$25 billion in 2005, with Chinese companies importing oil from Angola and Sudan, timber from Central Africa, and copper from Zambia.

South Africa is benefiting from robust exports to the region, helping to offset weak external demand in traditional trading partners. In the first eight months of this year, exports to SADC increased by 26.2 per cent compared with the same period in 2011, while exports to Europe declined by 4 per cent. The SADC region accounts for about 22 per cent of South Africa's manufactured exports, second to the EU.

While these patterns will support growth, more will be done to diversify exports towards manufactured value added goods. Raising competitiveness levels across the continent will be an important part of this strategy and will include addressing extensive infrastructure deficits, investing in human capital and technology, and improving business conditions in countries across Africa. In terms of the World Bank's ease of doing business indicator, just two sub-Saharan African economies are in the top 50 (Mauritius and South Africa), eight are in the top 100 while 30 are in the bottom 50 countries. There is considerable room for improvement.

Part of the changing growth prospects for Africa reflects technological progress and innovation. For example, cell phones are changing how Africans live. Health-care workers use cell phones to track and monitor pregnant women in rural Rwanda (where the number of maternal deaths is high), and HIV patients in Kenya. Kenya's mobile banking system, which has been labelled the world's most innovative, allows Kenyans to pay bills, send remittances, purchase goods and airtime, move funds among accounts, and even take out and pay back loans for entrepreneurial ventures.

Regional integration

Given the myriad of benefits, policy efforts and coordination will focus more closely on regional economic integration. The leaders of Africa through the African Union have developed an ambitious plan to improve infrastructure in Africa and thereby internal trade and connectivity. An important pillar to this is establishing efficient transport infrastructure. The World Bank estimates that it would cost US$93 billion a year over a decade to overcome Africa's infrastructure deficits. The Development Bank of Southern Africa (DBSA) is helping to plug the gap but the financial sector clearly has a role to play in infrastructure financing, and in helping release the opportunities for African growth.

Uniform competition rules, accelerated progress in removing trade barriers, especially non-tariff barriers like cumbersome customs procedures, restrictive rules of origin which limit preferential trade, poorly designed technical regulations and standards will support closer integration. Cooperation in the area of industrial development will help ensure that the trade relationship between South Africa and its regional partners is mutually beneficial.

Any jurisdiction that is able to position itself as the financial centre, channelling the resources required for the continents' growth, would itself see significant benefits.

Financial development for Africa and lessons from the crisis

What role can financial markets play in Africa's growth and development?

The financial sector can offer many benefits to the real economy – banks channel excess savings into investment, insurers help to pool risk, pension companies facilitate income smoothing over an individual's lifetime. Operating in this way, the financial sector can support and serve the real economy.

But the crisis taught us that the financial sector also has a "dark side" – I can hardly begin to list the various schemes, exotic derivatives and clever plots that some bankers undertook under the pretense of channelling savings into investment. Some insurers such as AIG created insurance products that magnified overall risk rather than reduced it. Some pension fund companies over-leveraged and chased short-term profits at the expense of long-term value. Together, these behaviours fundamentally eroded the stability of the financial system.

In Africa, there are a number of "principles" we should consider when thinking about financial development and learning the right lessons from the crisis.

Firstly, financial development should facilitate investment and growth, rather than encourage credit-fuelled consumerism and speculative activity, as this can exacerbate volatility with little long-term gain.

Secondly, profits should be distributed in an appropriate manner. The financial crisis has illustrated the destruction that can occur when underlying incentives are misaligned and risky behaviour is encouraged. We have seen that economic gains are often privatised, accruing to the wealthy, while losses are socialised, and must be carried by all. This is particularly important within the context of deep inequality on our continent. It is important to ensure the gains brought about by the financial sector and financial development accrue not only to the privileged few, but to the majority.

Thirdly, we have to avoid the negative impact of spillovers and collateral damage associated with financial crises. Sovereign and banking crises in Europe have led to European banks deleveraging to shore up their deteriorating domestic operations. In many instances, these banks have withdrawn capital from their African operations,

leading to reduced lending and economic activity, compounding the impact from lower external demand in major trading partners. And so the effects of over-indebtedness in Europe have spilt over to us, many miles away.

A fourth lesson is that there is only so much that regulation can achieve. At this year's Jackson Hole conference, Andrew Haldane, an Executive Director in charge of financial stability at the Bank of England, highlighted that the exceptional complexity of banking has resulted in ever more complex rules. This never ending hamster wheel of innovation, regulation and oversight, suggests the possibility of getting it wrong looms large.

Adair Turner, the FSA Chairman, and others, have spoken about the need for a shift in the mind-set of how banks operate and behave. This value shift is a not only needed for banking, but for society generally. Rabid profit maximisation at the expense of society ultimately harms everyone, and, as the crisis has shown, leaves us all poorer.

Facilitating financial development

After determined efforts to stabilize the macroeconomic environment, African governments are focused on ensuring that, among others, conditions are created for investment in infrastructure, the growth of the manufacturing sector and a sound financial sector.

The following are some of the institutional and other frameworks being put in place, which the IIF and other regulatory institutions are well-placed to support:

A*dequate regulatory frameworks*

Firstly, inadequate regulatory frameworks result in highly concentrated banking sectors, very low intermediation rates, and inefficient collateral registry systems that impede businesses and individuals' access to credit.

In addition to macroeconomic stability, effective enforcement of laws and regulations, effective competition policy in the financial sector, and functioning registration systems for assets are required.

According to the World Bank, the number one reason why individuals in Africa do not apply for, or are denied credit, is insufficient collateral. Collateral requirements in Africa are extremely high compared with other regions. According to the Africa Competitiveness Report 2009, collateral requirements are the second highest in the world, averaging 137 per cent of the loan value.

As a consequence of these challenges, banks tend to favour large enterprises and government assets to minimise risk. Information asymmetries and perceived, rather than actual, default risk have fragmented the financial system leaving a large part of the population without access to formal financial institutions.

Increasing competition, Reducing concentration

A determined effort will have to be made to increase competition in the financial sector. High levels of concentration lead to excess liquidity and risk aversion. The World Bank estimates that the average market share of the three largest banks in Africa is about 73 per cent. These oligopolistic banking sectors have a number of negative consequences, including high interest rate spreads and banking fees which crowd out credit to the private sector by making loans too costly.

Deeper and liquid markets

Deeper and more liquid financial markets need to be created across Africa. South Africa's financial markets are substantially more developed, including highly liquid nominal government bonds. Capital markets are largely underdeveloped in Africa. As income levels rise, and savings rates increase, capital markets will deepen. There are several programs in which South Africa participates with partners on the continent and outside to develop efficient capital markets and debt management systems in governments.

Increasing and appropriate levels of financial innovation

Different regions in Africa will have their own needs and preferences for financial products, as will investors. You can make an important contribution to developing a new generation of products that both learn from the crisis and respond to the specific needs of Africa, particularly for low income and poor households.

Your capacity to mobilize your resources and develop a new type of financial operative who is sensitive to the lessons of the crisis and to the need for "safe" and responsive products will be an important test for you.

The emergence of microfinance as a tool for financing the informal economy coincides with the growing understanding between NGOs, development experts and policymakers that most households in low income countries have no access to formal financial services. Innovative answers need to be found for the inaccessibility to credit of most African households because assets that can act as collateral, such as livestock, commodity stocks or property are held without proof of ownership (title deeds).

The role of South Africa

South Africa has close relationships and ties with our African partners. Our aspiration is to build on the formidable financial infrastructure we have to create a regional financial centre which, by partnering with other strong financial institutions across the continent, can offer diversified services that increase investment, trade finance, banking services for the unbanked, capital for entrepreneurs.

The financial sector is an important part of the South African economy, contributing 10.5 per cent of the gross domestic product. With a sophisticated financial services sector that boasts well-developed, deep and liquid financial markets, it is undeniable that South Africa is well positioned to take the lead in terms of driving infrastructure finance and financial development in the region.

Our regulatory framework is world class. In this year's World Economic Forum *Global Competitiveness Index*, South Africa ranked third out of 144 countries for financial market development. In terms of individual indicators, South Africa ranked first on the regulation of securities exchanges and its legal rights framework, second

for the availability of financial services and soundness of our banks, and third for the strength of local equity financing.

In 2010 South Africa became part of the BRICS. Many have predicted that the dynamic growth of the BRICS countries will bring about a shift in economic power toward the developing world, and South Africa, as the most developed country in Africa, offers the infrastructure and services to unlock the region's frontiers. We have come a long way, with improvements still to be made, but innovative programs, such as the African Development Bank's African Financial Market Initiative (AFMI) which specifically aim at the development of domestic African capital markets, are beginning to address some of these issues.

Conclusion

Africa is a continent of hope and expectation. In the midst of a global economy that is still in turmoil, Africans have a new determination to leverage their recent economic success into sustained growth and development which must result in a better life for a billion Africans.

All of us, as diverse as we are today, have our origins on this continent. We have an opportunity to be collaborators in crafting a new era of economic, social and political developments for a continent that will play a dynamic role in global growth and development. Our ultimate goals must be sustainable growth, job creation, and alleviating poverty and inequality.

How the financial sector interacts with the broader economy is complex and deep, but ultimately symbiotic. In cultivating Africa's financial system we must learn the lessons of the current crisis to encourage and establish a financial framework that works for Africa and supports inclusive growth and development on the continent.

I trust that your deliberations will thought-provoking and enable you to understand the dynamism of Africa and help to shape the type of financial sector that Africa needs.

Thank you.