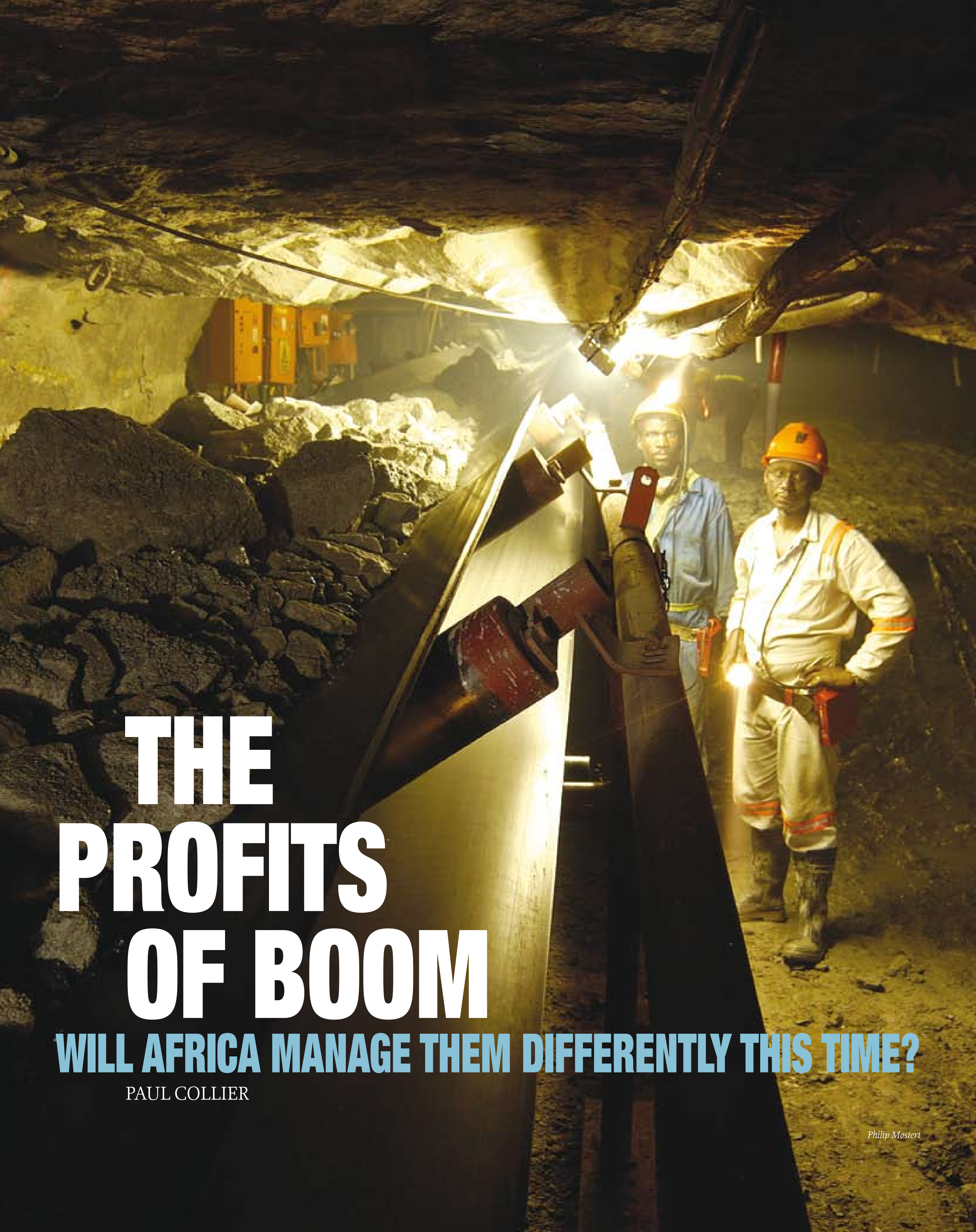

THE PROFITS OF BOOM

WILL AFRICA MANAGE THEM DIFFERENTLY THIS TIME?

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Philip Mostert

THE LATEST RESOURCE BOOM is the biggest opportunity Africa has ever had. Properly managed, the huge revenue flows can finance transformative public infrastructure and services, and the associated construction booms can provide jobs. But Africa experienced similar booms during the 1970s. Although they initially generated prosperity, the windfalls were largely dissipated in unsustainable consumption and unproductive public investment projects. Africa has had to wait for a generation before the opportunity has come round again: will this time be different or will history repeat itself?

Facing page: Underground in Zambia's Copperbelt. It remains to be seen how well Zambia will handle the sharply increased revenues that accrued from the recently-ended six-year boom in copper prices

First, a word of qualification: Africa includes many diverse economies and the opportunity from the latest commodity booms is not pan-African. Since the 1970s some countries have become net commodity importers, notably for food, the world price of which has also rocketed. As a first approximation, western Africa gains while eastern Africa loses: Nigeria and Angola are huge beneficiaries of the oil boom, whereas Madagascar is being hit by high prices for its oil and food imports. Nevertheless, Africa is an aggregate net exporter of commodities, two-thirds of which by value are oil. For the exporting countries the potential resource inflows dwarf aid and could be transformative. These are the countries on which I am going to focus.

Last time round

The booms of the 1970s were not harnessed for sustained development. Indeed, this was a global and not just an African experience. The typical pattern was that for the first few years high export prices would stimulate the economy, raising national production, but in the long term these output gains were not maintained. Usually, national output ended up lower than had there been no commodity boom. Nigeria fits this pattern. During the oil boom, living standards rose because oil revenues were spent on consumption. Indeed, the consumption bonanza was geared up by international borrowing. Once oil prices fell the legacy was not an accumulation of assets but an accumulation of debt: far from increased consumption being sustainable, it had to fall below its pre-oil level. Even worse than Nigeria, in Angola the revenues from oil and diamonds fuelled a prolonged civil war that drove the country deeper into poverty. Sometimes the problems were due to boom and bust. For example, during the brief coffee boom of the mid-1970s the government of Kenya increased public spending in a disorderly fashion, and then faced a prolonged agony of budget cuts once government revenues fell. During the boom the government committed itself to additional public consumption of doubtful benefit, such as an expansion of the civil service, whereas during the downturn the core capital investment programme had to be savaged. Sometimes the problem was a longer-term failure to invest productively. In Cameroon, for example, although oil reserves have been depleted over the decades there is little to show by way of improvements in public infrastructure.

This experience was not universal. Botswana, Malaysia and Norway are examples of countries in which resource revenues not only raised incomes in the short term but were in the long term transformative. Whether the opportunity becomes the foundation for prosperity depends upon a sequence of difficult economic decisions.

Harnessing resource exports

In essence, the key process for harnessing resource exports is simple. Resource extraction depletes natural assets from under the ground. For the extra revenues to be sustainable in the long term this loss of assets needs to be offset by the accumulation of productive assets above the ground. The transformation of assets beneath the ground to those above the ground splits into three steps.

Governments, firstly, need to capture a reasonable share of the revenues generated by resource extraction companies through taxation. Having received the revenues, governments, secondly, need to guard against consuming too much of them; since natural assets are depleting, using all the revenues for consumption would be unsustainable. Finally, the bulk of the resulting savings should normally be used for productive public investment within the country: building up financial honey pots abroad is both politically dangerous and misses the point that these economies are short of capital. This is a very difficult step because it is prone to corruption.

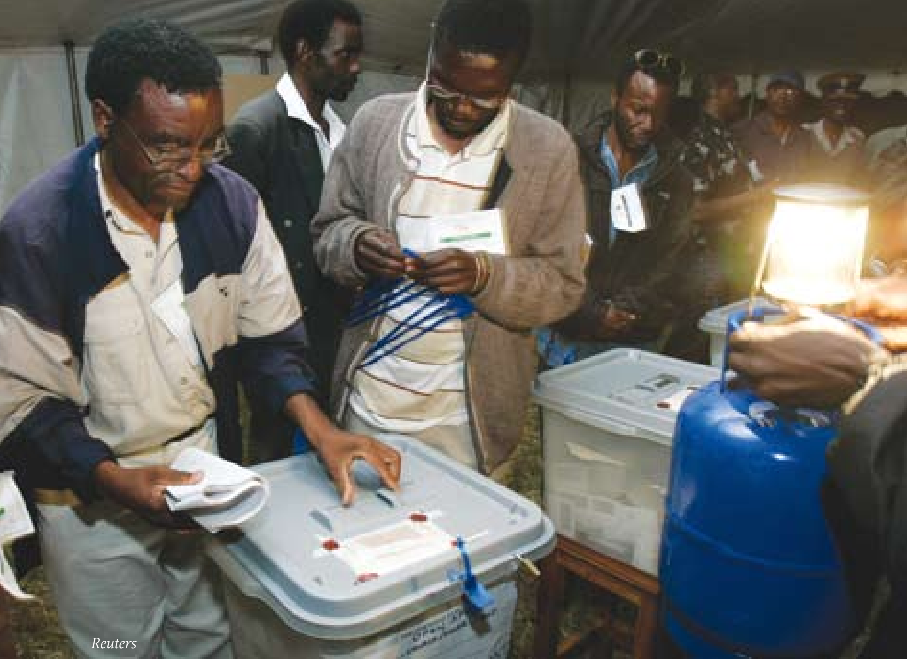
Using much of the resource revenues for public investment is important both to prevent increased consumption being unsustainable once natural assets have been depleted and because they are potentially transformative. As argued by the new Commission on Growth and Development, which brings together governments, business and policymakers, increased public investment is critical to economic take-off. While it is of course possible to waste money on unproductive infrastructure, no country has sustained rapid growth without a level of public investment considerably higher than that found in Africa to date. Good infrastructure is necessary for the private economy to grow and, in the long term, this is the route to raising the living standards of ordinary people. However, resource revenues can also bring substantial benefits to ordinary people in the here and now. Living standards depend primarily upon public services and jobs and the resource booms can enhance both.

In Kenya, during the brief coffee boom of the mid-1970s, the government increased public spending recklessly. As a result, it faced a prolonged agony of budget cuts once coffee revenue fell. Here, coffee beans are hand-sorted at a Kenyan plantation before bagging and exportation

Reuters

Some of the resource revenues can be used right from the start to finance sustainable increases in public consumption. The challenge here is to get value for money. Rapid increases in public spending generally reduce the quality of spending, and in much of Africa that quality is already low. However, the expansion of revenues provides an opportunity for experiment. Rather than simply increasing existing budgets proportionately, governments might use new money to pilot and evaluate alternative approaches to the delivery of public services, using decentralisation and sub-contracting. The expansion in education, health care, water and roads might all be done more cost-effectively by introducing an element of yardstick competition into their provision. It is politically very difficult to launch such experiments when the overall public budget is more or less constant because vested interests defend the status quo.

Usually, resource extraction does not directly provide much employment. However, as major revenues are spent on infrastructure, commodity booms generate construction booms. Construction can be labour-intensive and so these associated booms can generate jobs. But the construction booms themselves pose difficult challenges for governments. Unless bottlenecks are overcome, the extra demand for construction will drive up prices, dissipating much of the extra investment in higher costs rather than actually creating either more jobs or indeed more infrastructure. Governments need to focus on breaking the blockages: is land available,



Reuters

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Top: Counting votes late into the night after elections in Zimbabwe earlier this year. Despite the victory by the opposition MDC party, and a subsequent power-sharing agreement between Robert Mugabe's ZANU-PF party and the MDC, Mugabe continues to rule as president

Above: The widespread perception that political elites have misappropriated Nigeria's huge oil revenues is a major factor behind the rebel action in the Niger delta

is cement available, are government contracts of an appropriate size for local firms, are there shortages of construction skills?

Will future booms be different?

In one important respect future booms are likely to be easier to handle than those of the 1970s: they will probably be more persistent. The booms of the 1970s were due in part to the formation of the oil cartel, OPEC, and in part to the coincidence of cyclical expansions around the major economies of the OECD. Both these were inevitably short-lived. The recently-ended boom was underwritten by Asian economic growth, which is evidently here to stay. Although the slowdown in recent weeks, which has led to plummeting commodity prices, has once again highlighted the familiar pattern of boom followed by bust – a surge in public spending which then becomes unsustainable as revenues fall. Nevertheless, success still depends upon getting the three key decisions right: capture the revenues through taxation; save a substantial proportion of them; and use much of the savings for productive domestic investment.

Recent research suggests that the decisive feature of the countries in which these decisions were got sufficiently right that export earnings from resources were successfully harnessed, is the level of governance. Governance is a slippery concept, but political scientists have now developed a series of quantitative summary measures. According to these measures there is a threshold quality of governance below which the gains of the short term are not sustained. At the time of the previous commodity booms, the only African country to be above this governance threshold was Botswana.

Evidently, a key issue is whether governance in Africa's commodity exporters has improved sufficiently that they are now above the threshold. Since the previous booms, four aspects of governance have changed. I am going to suggest that cumulatively they are likely to make a difference.

The most high-profile change has been the spread of democracy across the region which followed the fall of the Soviet Union. Although this is the most prominent change, I am sceptical that it will in itself lead to a decisive improvement in the economic management of resource exports. It may be the transformation in governance that was needed, but the research evidence is not encouraging. Globally, democracies appear to handle large natural-resource revenues even worse than autocracies, at least in the sense of harnessing them for economic growth. Governance is not equivalent to democracy. A mature democracy has two features that are missing in autocracy: governments acquire power through electoral competition and their use of power is limited by checks and balances. Democracies differ a lot in both respects. In some, electoral competition is intense whereas checks and balances are weak, and in others the pattern is reversed. It turns out that this distinction matters for whether natural-

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China's model of resource extraction – opaque as it is – has led to fears that the package deals offered are another round of plunder in disguise – with Africa again being the loser. Featured is a Chinese oil rig on the west coast of Africa

resource revenues are harnessed for growth. Electoral competition actually makes things more difficult, whereas checks and balances greatly improve economic performance. A resource-rich country thus needs a somewhat distinctive form of democracy with particularly strong checks and balances. Unfortunately, with the exception of Botswana, the resource-rich countries of Africa tend to have the opposite (electoral competition, but weak checks and balances). Many of their democracies are recent, and it is easier to hold periodic elections than to build robust processes that limit government power. Further, the governments of resource-rich countries do not need to broaden the tax system much beyond the taxation of the resource base. As a result, citizens are not provoked by the burden of income taxation into scrutinising government. There is evidently a strong incentive for political elites to capture resource revenues for their own purposes and checks and balances get in the way. Over the course of a few decades, resource revenues tend to undermine those checks and balances a country initially has. Overall, the spread of democracy might not be sufficient to discipline governments into a better use of resource revenues. Indeed, most of the mistakes during the previous Nigerian oil boom were made while the country had a democratically elected government.

The second change is less evident but more robust: in the resource-rich countries people have learnt from past failure. Many Africans are acutely conscious that their natural assets are depleting and that the revenues must be used to leave a viable legacy for the next generation rather than to embark upon another consumption spree. For example, Nigerians know that they have little to show for the first oil boom and there is a determination that history should not be repeated. The minister of finance introduced a Fiscal Responsibility Act to ensure that a prudent share of oil revenues would be saved, and the governor of the central bank overhauled the banking system, previously an epicentre of corruption. Processes of learning from failure can generate dramatic changes in performance. Germany achieved the lowest inflation in post-war Europe precisely because it had previously been through a catastrophic episode of hyperinflation.

The third change is the emergence of corporate social responsibility and the global civil society as forces to be reckoned with. There is now global concern about the perils of misused resource revenues. The International Council on Mining & Metals, formed in 2001, is an example of how the corporate sector is coming together to share experience and concerns in preventing a repetition of previous disasters. Civil society activism, allied to the new sense of corporate responsibility, has led to the creation of two new international organisations concerned with the governance of resource revenues: the Kimberley Process and the Extractive Industries Transparency Initiative (EITI). The Kimberley Process has effectively addressed the problem of conflict diamonds andthe EITI is beginning to increase the transparency of resource revenues. No sooner had the EITI been launched than it was adopted and extended in Nigeria as the NEITI and many governments have already committed themselves to its standards. Preventing revenues from accruing to rebels and injecting transparency into revenue reporting were the right issues with which to start, but there is now scope to build on a successful model. The three key economic decisions of taxing, saving and investing could each be enshrined into voluntary international codes. Although voluntary, the codes might help to unite the disparate forces for reform in resource-rich countries around a common agenda. While the

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Botswana's capital, Gaborone. "Botswana, Malaysia and Norway are examples of countries in which resource revenues not only raised incomes in the short term, but were in the long term transformative."

need for good governance has become a mantra, it is so wide-ranging as to lack practical bite: highlighting three vital economic decisions would bring the governance agenda into focus.

The final change is the arrival of China. The emergence of China has added an important new dimension to competition for African natural resources and this is probably, on balance, a major force for good. China's new model of resource extraction in return for infrastructure is admittedly opaque and this has led to fears that the Chinese are getting natural assets on the cheap. A further weakness is that the Chinese model of construction is to import everything, including labour, and so the construction booms generate few direct benefits for ordinary people. But its offsetting virtue is its simplicity: it short-circuits many steps that have previously gone awry. Revenues are automatically and very speedily converted into domestic public investment without the need for much honesty or competence in public administration. Visionary African presidents who recognise the limitations of their own civil service may rightly find it superior to the slow and decentralised conventional decision-making processes that are easily subverted. Rather than criticising the Chinese model, the West might do better by copying it, offering competing packages of infrastructure financed by aid and resource extraction, and including more local construction employment. Competition would reveal whether the Chinese packaged deals are truly advantageous for Africa or yet another round of plunder in disguise.

Conclusion

The windfalls from the recently-ended commodity boom offer Africa its first real opportunity for transformative development in a generation. It is vital that history does not repeat itself, and I think that this time it will indeed be different. Of course, Africa is diverse and so there will surely be new instances of opportunities missed, but there are powerful forces that will prevent a repetition of history. The latest boom was exceptionally long and subsequent ones are likely to be more long-lasting than those of the last three decades of the 20th century. As a result, the opportunities will be bigger and, since revenues will be less volatile, they should be easier to handle. There is a huge new competitor. The new scramble for Africa between rising Asia and the OECD carries risks and it may trigger a race to the bottom. But it is more likely to be a force for good. It is introducing new and effective ways of converting depleting natural assets into productive domestic investment. Most fundamentally, there has been a gradual and unobtrusive process of social learning, with Africans themselves, the extractive industry, and international civil society learning from the mistakes of the past. People do learn from history. ◆

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