THE BRENTHURST FOUNDATION

Strengthening Africa's Economic Performance

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The Lake Kivu Consensus

AN AGENDA FOR A COMPETITIVE AFRICA

EXECUTIVE SUMMARY

TEN STRATEGIES TO IMPROVE AFRICAN COMPETITIVENESS

The Lake Kivu Consensus is the fruit of debate at two meetings in Italy and Rwanda in 2008, which identified competitiveness as the critical element in an *African strategy* to increase employment and prosperity. The global economic crisis and Africa's demographic bubble make the task all the more urgent.

Competitiveness is defined here as the ability to sustain an environment in which firms can profitably produce goods and services that the market will pay for.

The document proposes actions that African states can take, together with the private sector, NGOs, and aid donors, to improve the continent's economic competitiveness:

1) **Balance Reforms**: Focus not only on *macro*-economic (fiscal rectitude, monetary and trade policy for example) but also *micro*-economic reforms, notably policies relating to government tax and expenditure, ease of entry and exit of businesses, and other regulatory regimes.
2) **Reduce Costs, Hurdles and Uncertainty**: Removing bureaucratic bottlenecks, investing in infrastructure and skills, and ensuring the rule of law are key responsibilities of a government. Countries that do not also invest in health and education or protect the natural environment will not remain competitive for long.
3) **Benchmark**: Benchmarks for competitiveness should be developed as a way to compare and reduce the costs of doing business.
4) **Differentiate**: While some of Africa's challenges are continent-wide – growth rates tied to raw material prices, high utility costs, the absence of infrastructure, a low skills base, and a demographic boom – the presence of different kinds of states, from reformers to failures and the oil-rich to resource-poor, demands that strategies for competitiveness have to be tailored to country-specific circumstances.
5) **Compete for Investment, not Aid**: Allocate more government time to competing for investment, not negotiating aid packages. Build one-stop shops and simplify procedures for investors, not for donors.
6) **Develop Codes of Conduct**: Adopt codes of behaviour for business and for NGOs. Yet aim to reduce onerous business regulations and ensure predictability in regulatory adjustments and tax policy.
7) **Delink Domestic Reforms from Aid**: African governments should not make their own economic reforms conditional on the availability of aid. For example, in trade capacity and business climate reform, countries can achieve a tremendous amount on their own because the key ingredients are leadership and project management, not money.
8) **Maintain Key Expenditure**: Work with international financial institutions to ensure that government expenditures which are essential to economic progress are not restricted.
9) **Ensure Currency Competitiveness**: Guard against 'Dutch Disease', and ensure a competitive exchange rate.
10) **Build Growth Coalitions**: Develop a domestic consensus on the necessity of economic reform, the importance of high growth rates to reduce poverty, and the integration of the country in the global economy.

African countries which adopt these actions should not only become significantly more competitive but also experience major reductions in poverty.

INTRODUCTION: AN ENDURING CHALLENGE

Today, the only way a country can suffer real injustice at the hands of the global economy is by being excluded from it. Reforming for competitiveness has thus emerged as a leading African priority. There is no *one* path to a competitive economy. But all countries that aspire to a future beyond aid must diagnose and remedy the shortcomings that limit their participation in global trade.

The task of making African economies more competitive has never been more urgent. The high commodity prices that sustained growth rates of five percent per year over the past years are sharply down. As government revenues in industrialised countries contract, there will be a decline in aid flows to African governments. There will also be a reduction in remittances from Africans abroad, a major source of welfare and investment.

These realities underscore the importance of adding more value to African exports, making public investments in skills and institutions, and changing mindsets to enable Africa to fully participate in the world economy. This requires building coalitions for economic growth around the continent, so that the private sector's potential as a force for social good is better understood by African policy-makers, opinion-makers, and civil society groups.

Internal pressures are also creating momentum for action and change. By 2025, one in four young people worldwide will be from sub-Saharan Africa, making up 40 percent of Africa's working age population, and 60 percent of its unemployed. Poor living conditions and basic services coupled with Africa's high wealth inequality create huge potential for social destabilisation. The economic marginalisation of Africa's women constrains development further. If their talents are fully unleashed, Africa's women and youth will be an immensely powerful driver of positive change for the continent; if neglected, their plight could be a catalyst for social and political destabilisation.

For the past 25 years, the African reform agenda was driven by donor priorities. Policy prescriptions hewed closely to the so-called 'Washington Consensus', which emphasised both macro-economic discipline (which Africa has mostly maintained) together with, crucially, market liberalisation (which it has mostly avoided). The debate then evolved toward a focus on governance and institutions on the one hand, epitomised by the New Partnership for Africa's Development (NEPAD), and towards large public investments in 'human capital' on the other, as laid down most prominently in the UN Millennium Development Goals. More recently, Africa has looked to China's stunning growth record and asked whether there is a 'Beijing Consensus' that could serve as an alternative.

THE WASHINGTON CONSENSUS

John Williamson coined the term 'Washington Consensus'. He originally presented ten areas for reform of what many in Washington's international financial institutions believed Latin America (not all countries) ought to be undertaking as of 1989 (but not at all times). These included fiscal discipline, tax reform, liberalising interest rates, maintaining a competitive exchange rate, trade liberalisation, and privatisation.

The 'three big ideas' underlying this 'Consensus', Williamson argued, are: macro-economic discipline; a market economy; and openness to the world in respect of trade and investment.

Above the din, Africa has struggled to articulate a reform agenda of its own. Perpetual economic and security crises have compounded the weakness of African governments and made it more difficult to devise and implement reforms. With very few exceptions, robust domestic constituencies for reform have yet to emerge anywhere on the continent.

The process which resulted in *this* Consensus started from the premise that improved African competitiveness is vital for development. The challenge was not so much to argue for this imperative as to explain what needs to be done to achieve it.

The Consensus was the result of a collaboration between the Brenthurst Foundation, the African Economic Research Consortium, Business Leadership South Africa, and the Konrad-Adenauer-Stiftung. The process brought together businesspeople, policy-makers, journalists, academics and thought-leaders in meetings held at Villa La Collina in Cadenabbia, Italy on 26-28 May 2008, and on the shores of Lake Kivu in Gisenyi, Rwanda on 14-15 December 2008. A list of the participants can be found in the Appendix.

THE AFRICAN COMPETITIVENESS CHALLENGE

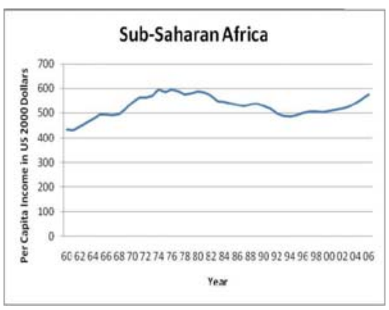
The main problem affecting Africa's development is how difficult it is to do business there. Africa is the least business-friendly continent according to the World Bank's annual *Doing Business* survey. African countries rank 136th on average, compared to 87th for Latin American and Caribbean countries. Securing Africa's future depends on removing the barriers that reduce competitiveness in the private sector — particularly those caused by ill-conceived government interventions.

The competitiveness of a country is the ability to sustain an environment in which firms can profitably produce goods and services that the market will pay for. Removing bureaucratic bottlenecks, investing in infrastructure and skills, and ensuring the rule of law are the main responsibilities of a government. Of course, countries that do not also invest in health and education or protect the natural environment will not remain competitive for long.

There have been two important changes in Africa which allow for a focus on competitiveness. First, democracy is more widespread than at any point since independence. Second, Africa has recently enjoyed a half-decade of economic growth, reducing resistance to market reforms.

AFRICA'S ECONOMIC HISTORY

While it is difficult to generalise about forty-eight countries, sub-Saharan Africa's post-colonial economic history can be divided into three phases. In the 1960s, African economies grew, fuelled by high natural resources prices. Per capita incomes probably peaked in the mid-1970s.



There followed a period of decline that lasted until the mid-1990s, brought on by the oil price shock, lower raw material prices, and the multiple economic distortions introduced by bad government policy. Over the past fifteen years, African growth rates have picked up, spurred by economic reform and renewed demand for the continent's natural resources. Yet, on average, per capita income in Africa today is still lower than in the mid-1970s.

Democracy is important in itself, but it also enhances economic and social performance. Recent research shows that over the last two decades, only eight of 65 autocracies recorded growth, while at least one-third of this total number recorded at least one year of acute economic contraction. Among developing countries outside of East Asia, between 1960-2003, democracies grew their economies 50 percent faster than autocracies.

Democracies reduce costs by avoiding conflict, improving public scrutiny of government spending, and making government more responsive. Democracies do a better job of creating 'accountability institutions' that enforce the rule of law, check executive power, deter corruption, and separate political allegiance from public opportunity.

In particular, democracies may be more able to *sustain* the kind of political consensus around reform that distinguishes successful reformers from stagnant failures. The reason that Africa has become poorer since independence is not primarily because the advice it got was bad, but because few countries were able to construct a domestic political consensus around reform and private-sector growth. The important reforms are politically painful because they require the state to surrender power to the market and to the private sector, and because they challenge the protected status of politically-connected monopolies.

MEXICO: SEQUENCING REFORM, DEALING WITH VESTED INTERESTS

Mexico has made a remarkable transformation during the past quarter century, evolving from a country with a closed economy and political system, to a viable democracy, with a stable currency and consistent, if lacklustre, economic growth and capital formation that ranks it as one of the world's top 15 economies. In 1994, Mexico began its economic integration with the United States and Canada with the North American Free Trade Agreement (NAFTA). In 2000, Vicente Fox was elected president, and ended the monopoly on power that the Institutional Revolutionary Party, or PRI, enjoyed. In 2007, Mexicans living abroad, primarily in the United States and Canada, sent an astonishing US$24 billion to their home country. These remittances became the largest source of foreign revenues, fuelling the nation's trade surplus — with so many dollars coming in, the peso remains a strong and stable currency.

In the process of adopting structural changes to the Mexican economy and political system, governments over the past 20 years have opted for a two-track approach. First was the decision to open up the economy by joining the world trading system (GATT and later the WTO), negotiating free trade agreements with its principal trading partners and joining the Organisation for Economic Co-operation and Development (OECD), Asia-Pacific Economic Co-operation (APEC) forum, and other global partnerships. At the same time, basic structural changes to intellectual property laws, the judicial system, land tenure, electoral rules and fiscal reform laid the foundation for a more competitive country receptive to foreign direct investment and open to the globalised trading system. The last stage consisted of legislation to guarantee transparency and good governance within the public sector and public/private partnerships for investment in infrastructure. All these fundamental changes to the Mexican economy and political system have given the country the necessary instruments to compete, not only with its immediate neighbours in North and Latin America, but also with Europe and Asia.

This internal political work is the core of the elusive idea of ‘ownership’, which is frequently identified as the *sine qua non* of development success. Outsiders cannot manufacture it, and no country can succeed without it.

EL SALVADOR: DEVELOPING FROM A BANANA REPUBLIC

El Salvador is showing how the past is not prologue. It is possible to deal with a violent history, strong political polarisation, skewed wealth distribution, high crime rates, a dependency on agriculture, and deforestation. It is possible, too, to turn regional location to strategic advantage.

The civil war left 75,000 dead and cost US$5 billion. GDP fell 20 percent. But it precipitated political and economic reforms following a 1992 peace agreement in which the commitment to democracy is a key pillar in the rebuilding process. Since that time, El Salvador has diligently followed the usual economic reform prescriptions including privatisation, tax reform, a 2001 dollarisation and trade liberalisation. The Central American Free Trade Agreement is starting to produce results, eliminating all tariff and investment barriers with the US and the five Central American states.

El Salvador’s annual GDP growth has recently grown at nearly five percent after many years of remaining stuck at 1.5 percent. The government has seized on key projects to drive higher growth rates. San Salvador has quickly become a regional air transport hub, uniting North and South America with Central America. El Salvador’s investment promotion agency has successfully targeted high-tech industries, including Dell which established a back-office English-Spanish call-centre. Also the financial sector as a whole was sold to first class international banks and many European and American investors have bought strategic businesses such as the brewery, cement, pension funds, insurance companies and many others, investing more than US$3 billion since 2005.

El Salvador has had little option in making its own plans for a more positive future, showing that, above all else, salvation has to come from within. This should give heart to those African states emerging from conflict with few apparent development options other than increasing aid. If conflict-torn El Salvador can make it, why shouldn’t they?

Fortunately there is more openness to economic reforms in Africa today. Some of the most important debates — including on the need for a competitive exchange rate, the importance of the private sector, and the relationship between state and market — are becoming less contentious even if they are not yet fully resolved.

But, having made difficult choices, some African countries are seeing the benefits in the form of significant new domestic and foreign investment. Many others across the continent are now putting these building blocks in place.

THE GEORGIAN AGE

Since its 2003 Rose Revolution, Georgia has been a model reformer, built on the back of increased freedoms and improving competitiveness, including the privatisation of thousands of state-owned industries, the shift to a flat corporate tax of 15 percent (down from 47 percent), the abolition of taxes on capital gains, interest, and dividends, resulting in dramatically higher government revenues. Georgia's markets are among the most open in the world (for example, Georgian import duties compare with those of Singapore and Hong Kong – countries Georgia took as models when rewriting its laws).

By slashing the number of licences, permits, and permissions required for construction and commercial processes, and by requiring the government to respond to each request within a set period (usually two weeks), Georgia has achieved a historic decline in corruption levels.

Government's aim has been to provide the environment in which business could thrive, rather than promote any particular sectors. Thus growth has not only come from services such as tourism, but unexpected areas such as hair transplants for the South Korean market.

Georgia is also a model of economic freedom, usually taking dramatic reform measures unilaterally, without the feared consequences that usually deter countries from doing so. It has removed visa and work permit requirements on citizens from 50 countries. It recognises the technical regulations and quality inspections of most OECD and EU countries, eliminating the need for duplicative Georgian certifications. It also uses such 'profiling' in financial regulation.

Georgia was the top reformer worldwide in 2007 in terms of the ease of doing business, as measured by the World Bank, climbing from 112th to 37th place in one year, the biggest progress ever made, and moving up to 18th (out of 178 countries) by 2008. The number of licences required to do business has decreased nearly tenfold. Between 2002-05, according to the World Bank, it made the largest reduction in corruption among all transition countries. As a result of several years of 10 percent economic growth, poverty among the country's 4.5 million citizens has fallen dramatically from 54 percent in 2001 to 34 percent in 2006. While the economy has suffered from the twin shocks of the August 2008 war with Russia and the concomitant global economic crisis, the foundations for long-term prosperity remain. Indeed, Georgia is one of the few countries in the world that expects to enjoy a budget *surplus* in 2009.

The lessons for others, says former Prime Minister Lado Gurgenidze, are simple: 'Have flat taxes, no currency or capital controls, full flexibility of labour markets, eliminate red tape, show zero tolerance for corruption, and ensure protection for investors.' There is less to risk in these measures than developing countries fear, and much to gain.

Developing countries — including once grossly inefficient India and Mexico — are showing how reform leads to growth and new opportunity for the poor. This serves as an inspiration to Africa, but it is also a warning that Africa is trailing the rest of the developing world. The development strategies pursued by other poor countries may in fact close off some avenues for African growth, though new opportunities may be created in the process.

INDIA: ESCAPING A 'HINDU' RATE OF GROWTH

The mythology is that India's economy was mired in an unchanging, sub-optimal 'Hindu' rate of growth of 3.5 percent, until it broke out with the help of widespread economic reforms in 1991. Even as the Hindu rate of growth thesis was being spun out in 1980, India had already moved from 3.5 percent to more than 5.5 percent annual GDP growth, helped by a substantial increase in the level of savings and investment in the economy to nearly 25 percent of GDP (up from 10 percent at the time of independence from British rule in 1947). Despite the reforms that were introduced in 1991, India remained at under 6 percent annual growth till the last five years (2003-08), which have seen a quantum leap to 8.8 percent and made it the world's fastest growing economy after China – helped by a further increase in savings and investment levels, to about 35 percent of GDP.

Reform did not begin in 1990. It began a decade earlier when the pervasive system of state controls on industry and enterprise began to get unshackled in slow steps. The foundations for success were laid as far back as in the 1960s, through the setting-up of elite institutions of higher education in technology and management, and the start of the Green Revolution spurring agricultural productivity which ended food shortages. Nor did the Indian middle class emerge suddenly from nowhere. It grew in slow stages till (from the viewpoint of market size) it reached critical mass in the mid-1980s.

VIETNAM: RIGHTING ECONOMIC FUNDAMENTALS

After the end of the war in 1975, Vietnam was an economic basket-case whose best known export was the refugees who fled its shores in droves. Since the government embraced *doi moi* (‘innovation’) beginning in 1986, abandoning agricultural collectivisation in favour of private ownership, the transformation has been dramatic. In fact, many of the ‘boat people’ have been returning to take advantage of Vietnam’s promising future.

As the collapsing Soviet Union withdrew its last subsidies in the mid-1980s, Vietnam, once one of the world’s largest rice exporters, found itself forced to import more than 1.5 million tons of rice each year just to stave off mass famine. The crisis gave reformers within the ruling Communist Party an opportunity to win political support for a transition from the failed command economy to a market economy. Initial policies permitted the decentralisation of state economic management, allowing industries local autonomy; the replacement of administrative measures with economic mechanisms, including a market-oriented monetary policy which helped control inflation; the adoption of outward-oriented policies in external economic relations, including allowing exchange and interest rates to respond to market conditions; the establishment of agricultural policies that allowed for long-term land use rights, encouraging investments; the reliance on the private sector as the engine for economic growth; and the allowing of both state and private industries to deal directly with foreign partners for both imports and exports. Subsequent *doi moi* reforms included the revision of the foreign investment law; the virtual elimination of all direct subsidies and price control regimes; opening the banking sector to foreign participation; the creation of export processing zones that allowed for 100 percent foreign ownership; dismantling of most of the central planning bureaucracy; and the return to former owners and their heirs of businesses confiscated or nationalised after unification in 1975 on condition that they invest in the enterprises.

As a direct result of these reforms, Vietnam is today the world’s second-largest rice exporter as well as its second-largest coffee producer and largest exporter of Robusta beans. Over the past decade, annual economic growth has averaged 7.5 percent, driven by manufacturers ranging from small textile firms to Intel’s new US$1 billion semiconductor facility, the microchip giant’s biggest single foreign investment. Moreover, unlike their 1.3 billion neighbours to the north in the People’s Republic of China, the 86 million Vietnamese have done a fairly credible job of poverty reduction and maintaining social cohesion. For example, Vietnam’s Gini coefficient, a measure of wealth inequality, has remained steady around 37, whereas China’s, currently 47, has edged increasingly upward – the explanation seems to be the sustained expansion of the former’s middle class coupled with a drop in its poverty rate to under 14 percent in 2007 from more than 75 percent in 1990, an achievement the World Bank described as ‘one of the most successful anti-poverty campaigns ever.’ A national electrification campaign has brought power to some 90 percent of homes. Almost all children at least begin secondary education, with some two-thirds completing it. A national unemployment insurance plan is due to be introduced in 2009.

Vietnam’s experience points the way for other states emerging from conflict and caught in economic doldrums: getting the fundamentals of economic structure right can unleash a country’s growth potential.

Trade integration benefits countries with lower-priced goods or services. Developing countries that open more to the global economy grow faster. This does not mean that integration reduces inequality; indeed, it can increase the income gap. But global trade favours the domestic sectors most in abundance — labour, raw materials, land, or capital — and Africa is blessed with the first three. It is not in Africa’s interest to adopt protectionist policies, but there are ways for governments to support fledgling industries and mitigate the impact of income inequalities.

COSTA RICA: FROM COFFEE TO COMPUTER CHIPS

Costa Rica’s economy has grown five percent annually over the past two decades, going from an agricultural to a high-tech and services’ base: from coffee and bananas to computer chips, medical equipment and high quality services. It is now the home of many cutting-edge factories including Intel, today manufacturing one-quarter of the world’s computer chips. Exports have risen ten percent per annum from US$870 million 25 years ago to US$10 billion in 2008, extraordinary for a four-million-person economy. This has not been at the neglect of agriculture which once accounted for two-thirds of all exports. That sector, too, has diversified and increased outputs even though its export share has fallen to just 14 percent. Costa Rica is still, today, the sixth-largest per capita agriculture exporter world-wide. The key lesson is that this has been built on openness to trade and capital, by using one’s head and good policy as the principal tools. Indeed, one of the first questions that needs to be asked in such a reform and growth process, as evidenced by Costa Rica’s success, is for countries to ask *themselves*: What is it that they are good at?

As seen from international experience, policy changes can improve the ability of companies to compete on the international stage. El Salvador's transition was built on ending the civil war, stabilisation, and privatisation, turning regional location to its advantage through heavy investment in infrastructure. Georgia and India both illustrate the benefits of deregulation. Vietnam displays the importance of private ownership and diaspora involvement as a key means of increasing output and investment. Costa Rica shows how to diversify while retaining a strong commodities sector. All illustrate how the private sector can be the engine of poverty-reduction, and that government should facilitate the transformation.

Of course, the sequencing of reforms varies based on a country's comparative advantage and factor endowments. That is why there is no check-list that governments can use to manage reforms.

ACCEPTING DIFFERENTIATION

A number of general principles can be established, however, for all reformers, though they must be adapted to local circumstances. Some of Africa's challenges are continent-wide: growth rates tied to raw material prices, high utility costs, the absence of infrastructure, a low skills base, and a demographic boom.

DIFFERENTIATING AFRICA

Perhaps the most important trend in Africa over the last fifty years has been the increasing heterogeneity of countries' economic performances. Botswana and Mauritius have managed to significantly improve their per capita income through excellent governance. These countries have done well for their populations, but are so small that their example has negligible impact elsewhere.

A few other countries — including Ghana, Namibia, Mozambique, and South Africa — have institutionalised important improvements in governance even if they have not yet experienced large economic gains. A much larger number of African countries have adopted some economic reforms, but have not institutionalised enough of the governance agenda to develop forward economic momentum. These countries grew during the recent commodity boom but now face modest economic circumstances now that the prices of their raw material exports are declining.

There are also a set of African countries (such as the Democratic Republic of Congo, Liberia, Sierra Leone, and Zimbabwe) that have experienced significant deterioration of their basic institutions as conflict and poor management have sentenced their populations to widespread and often growing misery, though some (Liberia, for example) are beginning to successfully navigate their way out of this situation. Finally, Africa's oil producers (including Angola, Equatorial Guinea, and Nigeria) are in significant ways different from other countries because petroleum produces so much revenue for leaders that there is often no real incentive to promote good governance and diversification of the economy, even though oil will never be bountiful enough to make whole countries rich.

Such heterogeneity should guide external engagement with Africa; a failure to adopt a differentiated approach also illustrates why the gains of African states are too often overlooked in sweeping external views of the continent.

It is recognised that there are different kinds of states, including those who have made considerable progress in adopting economic reforms, those whose reform agenda is still incomplete, and oil exporters who receive so much money from their hydro-carbon resources that they can resist pressure to reform.

Each of these states faces different challenges in reducing costs and becoming competitive. Those which have already reformed must now woo foreign investment. Those countries which have not yet made significant reform progress should at least attempt to draw more of the domestic economy into the formal sector. Oil and other natural resource producers must work diligently to make sure that revenue from their major export does not overwhelm the economy and make it prohibitively costly to do business elsewhere.

AN AGENDA FOR THE FUTURE

Policy Goals for Competitiveness

The development debate is no longer about the balance between state and market, but about the need for more markets and more effective governments. It is about firms, both local and foreign, that compete *from Africa* in the world market.

Development through competitiveness requires:

- An analysis of the cost structure of the economy and a commitment to tackle the most expensive problems first.
- Locating national competitiveness at the heart of political debate. Growing competitiveness regionally and internationally should be a key political goal, and it should be identified as such to voters and duelled over by political parties.
- An ongoing process of identifying sectors of the economy which can be competitive given continual changes in the international economy.

What African Governments Must Do

African governments need to identify growth opportunities and encourage a domestic development debate. Citizens have to know that they are competing against the rest of the world. This requires changing the mindset of development policy-makers from focussing on aid and donors to investment and business.

BENCHMARKS FOR COMPETITIVENESS

Part of the rethink on African development should involve complementing the UN's Millennium Development Goals with a set of benchmarks for competitiveness – a form of *'MDGs for Competitiveness'.* By incorporating measures of economic innovation and administrative efficiency, such goals would help to set the conditions in which countries could build business and in so doing *trade their way out of poverty.* It would address those indicators that entrepreneurs find to be the main obstacles to running a business: the cost of capital, electricity, transport, telecommunications, taxes, labour, and corruption. It would build on and synthesise the useful work of the World Bank and others including the World Economic Forum in detailing the impediments to doing business in Africa compared to each other and the rest of the world.

Thus African governments should:

- Instigate their own domestically-owned development debate.
- Allocate government time to encouraging investment, not negotiating aid packages. Building one-stop shops for investors, not for donors, is important.
- Ensure the macro-economic fundamentals are sound, including fiscal rectitude and trade and monetary policy.
- Simplify codes of conduct for businesses.
- Ensure predictability in regulatory changes and tax policy.
- Build a healthy credit market that can serve small and medium-sized customers, both firms and individual entrepreneurs.
- Ensure a competitive exchange rate.

ENSURING A COMPETITIVE EXCHANGE RATE

Even when a country has successfully achieved domestic competitiveness, the price at which its goods trade on international markets is determined by its exchange rate. An overvalued exchange rate can fully offset domestic competitiveness gains and continue to prevent successful export promotion. Almost all rapidly growing developing countries have begun their periods of economic success with competitively valued exchange rates and rapid export growth. Japan, Korea, Taiwan, Chile and Malaysia all started their periods of rapid growth with weak exchange rates. Likewise, China's extraordinary economic success has been supported by an initially weak currency, rapid export growth and fierce resistance to a reduction of its global competitiveness as a result of currency appreciation. In contrast, poor economic performance has often been blamed on overvalued exchange rates in countries benefiting from temporarily high commodity prices (the so-called 'Dutch disease' — see below), or from short-term capital inflows attracted by high domestic interest rates, or significant donor funding.

Maintaining a competitive exchange rate requires deliberate policy reaction as the more successful a country's export performance, the more its currency starts to strengthen. Policies to prevent currency appreciation include Central Bank purchases of foreign exchange reserves, the temporary holding offshore of currency receipts in sovereign wealth funds for later use, policies to discourage short-term capital inflows, and the opening of domestic markets to encourage imports as well as investment abroad.

Furthermore, African governments must focus on:

- Identifying the sectors of greatest comparative advantage, including tourism and other services, natural resource extraction and beneficiation, and agriculture.
- Building infrastructure to raise productivity.
- Professionalising (and depoliticising) the civil service.
- Benchmarking national competitiveness – against the rest of the world.
- Combating monopolies – particularly politically-connected ones – and always put consumer interests ahead of producer interests; this makes producers more competitive.
- Reducing the costs of legalisation and formal sector business activity, while raising the costs of continued informal business transactions.
- Developing linkages to the African diaspora, rather than focusing on the 'brain drain'. Such clearly dynamic individuals should be engaged positively, both in improving the competitiveness of African countries through technology, financial and skills' flows, and in being advocates for 'Africa' in countries where they have settled. In the United States alone, for example, there are at least 1.3 million African immigrants. While they represent only 3.6 percent of all of America's foreign-born residents, they account for 17.7 percent of all legal arrivals since 2000.
- Encouraging tax and revenue collection principally by raising the benefits through better infrastructure and state services.
- Developing 'New Agriculture', but being clear about what support and investment are required to succeed.

AFRICA'S 'NEW AGRICULTURE' FOCUS

Despite natural advantages, African countries have traditionally had among the worst-performing agricultural sectors world-wide. As a result, of sub-Saharan Africa's 48 economies, 35 are net food importers. While, for example, East Asian countries have tripled agricultural yields in the last four decades, Africa has lagged behind, with yields remaining more or less flat.

Low productivity coupled with poor infrastructure and weak domestic markets pose a threat to African development in making more difficult the export of surpluses to the cities. Coupled with high food prices, this may have a more pernicious effect as a catalyst for political tension especially in an urban setting. But much is known today about how to create the conditions for a 'Green Revolution'. It requires, as summarised by the Rockefeller Foundation, the following elements:

- More productive crops and fertilizers developed through applied research;
- Local talent in plant science, farming, agricultural policy, and business;
- Commitment from national governments;
- Public-private collaboration on infrastructure, water, irrigation and the environment; and
- Building markets.

The direct relationship between agriculture performance and trade should be emphasised. For almost half of sub-Saharan countries, transport payments absorb over 20 percent of foreign earnings from exports. For some landlocked nations, these costs absorb over 50 percent. Particularly significant is the negative impact of poor transport infrastructure on rural development, making it difficult for African farmers to specialise in high value crops for export. These are not only *transportation charges* due to poor infrastructure, but *trade costs* caused by inefficient customs and clearance procedures, themselves the product of an overbearing and inefficient bureaucracy, uncompetitive mindset and policy environment.

The rise in food prices, a part of which is unlikely to be reversed, presents Africa with a paradoxical combination of political crisis and, if agriculture is revived, economic opportunity for 180 million small farmers. It would be a tragedy if the crisis is faced, but the opportunity missed.

The Role of the Private Sector and Non-Government Actors

National competitiveness depends on government policy and action. But NGOs, foundations, and philanthropists can help.

Civil society can create the impetus for change and work to check executive power. But there is also a need for civil society organisations to:

- Streamline and accept codes of behaviour for business and for other actors such as NGOs, while noting the national need for greater competitiveness through lower costs to doing business.
- Play a greater role in economics education, and in supporting individual entrepreneurs to develop their business plans.
- Educate legislators and parliamentary staffs on the legal and regulatory aspects of a competitive business environment.
- Show how consumers, workers, and the environment can be protected without imposing prohibitive costs on business.
- Focus policy attention on the urban-rural divide.

How Aid Can Be Managed Better

Since development is a political process, its success is dependent on local ownership; African policy-makers need to set the priorities, not donors. Priorities have to be identified according to the circumstances of each country. In finding a balance between what governments need and donors want to give, donors must:

- Support national growth and cost-reduction agendas, avoiding the urge to devise them externally or seek 'perfect' policy solutions.
- Along with international financial institutions, take care not to restrict government expenditures that are essential to economic progress.
- Co-operate with the private sector in delivering infrastructure.
- Recognise and avoid other negative side-effects of aid-inflows, including 'Dutch disease' and the inflation of exchange rates along with the gearing of resources to donor rather than business concerns and needs.

AVOIDING 'DUTCH DISEASE'

The term 'Dutch disease' has its origins in a crisis in the Netherlands in the 1960s resulting from discoveries of North Sea gas deposits, causing the Dutch gilder to rise, making exports of all non-oil products less competitive on the global market. The same condition occurred in Britain in the 1970s as the result of North Sea oil. While Dutch disease is primarily associated with the impact of natural resources and is of concern especially to resource-rich African countries, it can result from any large boost in foreign currency, including foreign direct investment and donor aid. The resultant increase in imports and decrease in exports from the increase in the real exchange rate which ensues can contribute to manufacturing jobs being moved to lower-cost countries.

There are three basic ways to reduce the threat of Dutch disease:

First, by slowing the appreciation of the real exchange rate by 'sterilisation' of incomes, not bringing all the revenues into the country at once, and to save and disperse them in a manner that ensures a stable revenue stream. A second strategy for avoiding real exchange rate appreciation is to increase domestic savings in the economy in order to reduce large capital inflows. This can be done if the country runs a budget surplus. A country can encourage individuals and firms to save more by reducing income- and profit-taxes. Increased savings can reduce the need for loans to finance government deficits and foreign direct investment. The third way is by boosting the competitiveness of the manufacturing sector, by increasing investments in education and infrastructure.

Overall, the key to avoiding Dutch disease is governance. Rent-seeking and currency over-valuation can best be avoided by ensuring sound economic fundamentals: good monetary policy, open trading and investment regimes, transparently-enforced laws against corruption, rule of law, and long-term investments in people, health and infrastructure.

TOWARDS A COMPETITIVE AFRICA

Africa can forge a pathway to economic success by building ‘coalitions for growth’ across the continent. This is an unprecedented challenge: Africa must clear a high set of reform and public investment hurdles within a short timeframe, when compared with the history of economic growth in Europe or even Asia. Moreover, Africa must do so at a time of global economic volatility.

BUILDING COALITIONS FOR GROWTH IN AFRICA

Growth in Africa has mostly been a function of global commodity prices. It is a long way from being an autonomous force based on the development and application of human capital to production for world markets — the driver of long-run growth elsewhere.

This needs to change. Yet each country is a crowded stage of domestic players, bilateral aid agencies, multilaterals, NGOs, consultants, development foundations and foreign governments. The cacophony can overwhelm and disorient, and often becomes a source of patronage of political power rather than being, as was intended, a source of development funding and advice. Instead of focusing on growth, these institutions often divert political leaders’ attention from real problems.

The world is now into the fifth decade of international development support for Africa, and patterns are emerging. These patterns are the result of similar trends in thinking and activities of the major international aid organizations. Broadly speaking, the history of development assistance can be summarized as a successive focus on providing *resources* (mid-1960s to mid-1980s), on providing *policies* (mid-1980s to approximately 2000), and on building *capacity* to implement those policies (from 1995 to 2005). In the last few years the focus has swung back to *resources* with the fashion for quantitative targets set in international forums, translating into large-scale budget support in the region.

This cycle will likely continue, and the results will be disappointing. This is not because of faulty economic reasoning on the part of the large donors: resources, policies, and implementation capacity are indeed the instruments through which growth can be achieved. But if a country’s leaders have other priorities, these inputs will still not produce results.

That is the missing dimension: the priorities of leadership groups. With growth as a priority, resources can be mobilised, policies written, and novel solutions brought to bear to assist with implementation. When other priorities hold sway, growth is stymied in ways that can be difficult for outsiders to understand. All of this points to a problem with the priority given to growth, which in turn indicates that the coalition necessary to govern is held together by other things, but not by a growth agenda. Political motives are always mixed, but only where a country has a sufficiently strong domestic coalition for growth is it likely that growth-oriented public policy will be pursued with vigour and determination.

It is not surprising that multilateral and bilateral organizations do not succeed at building coalitions for growth. These organisations are fundamentally technocratic, and constrained by the etiquette of sovereignty. Yet coalition-building is a fundamentally political exercise.

The only way that African prosperity and stability can be achieved is if the continent’s entrepreneurs, unshackled by government, begin to learn what they can sell to the world better than other nations can. Success will require action by government: Major investments in human and physical capital, along with policy specifically aimed at reducing the costs to and constraints on doing business.

Donors must restrain the impulse to answer key questions on Africa’s behalf. What matters most is what Africa can do for itself, even if it seems less than what can be done for it. Only African governments acting together with businesses, legislators, and civil society can create the political coalition that will be required along the difficult development road ahead.

In many African countries, the dialogue about reform and prosperity has yet to begin. The Lake Kivu Consensus is a step in that ladder.

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Appendix: Participants*

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* Denotes attendance at both meetings in Como and Kivu in May and December 2008 respectively; no asterisk denotes participation at one meeting only. The last-named country refers to the participant's national origin.