TRANSCRIPT OF DEVELOPMENT DRUMS
[EPISODE 4 – GABARONE]

Host: Owen Barder. Guests: Sheila Page and Shanta Devarajan
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Owen Barder
Thank you for listening to the fourth edition of Development Drums recorded on the 31, October 2008 and for those of you who like your festivals pagan, Happy Halloween. Development Drums aims to give busy people working in development, a short update on the latest news with some stimulating comment from the experts and there is a lot to talk about this week.

I will be talking to Sheila Page from the Overseas Development Institute about proposals for a new free trade area in Africa and we will be looking again at the impact of the financial crisis of developing countries. And will ask whether it's a good idea to give a prize for good governance to African leaders.

I am joined today by Shanta Devarajan. Shanta is currently the Chief Economist of the World Bank's Africa region. He has previously been Chief Economist for the South Asia region and for the Human Development Network at the World Bank. And notably he was the Director for the World Development Report in 2004 on making services work for poor people. He also writes an excellent blog on Africa Economics and Development.

Shanta welcome to Development Drums.

Shanta Devarajan
Thanks very much, Owen, nice to be here.

Owen Barder
Let's start with the financial crisis and the impact on developing countries. We had rather a gloomy conversation about this in last week's episode both about the effects of the crisis on foreign aid and on the broader economic effects on developing countries. Shanta, in your blog, you were quite optimistic that aid would be sustained despite the financial crisis. Are you generally sanguine about the effects of the crisis on developing countries?

Shanta Devarajan
No, I think there are profoundly disturbing effects but I don't think foreign aid is going to be the big driver. I think the biggest effect that I am concerned about is the shortfall in private capital flows. Private capital flows have been rising in Africa. In fact it's the fastest rising region in the world. And as we know since the main effect of the global financial crisis is a contraction in credit as well as a reduction in the appetite for risk of our investors, there are many very good investment projects in Africa that may have to be postponed or even canceled because the private finance that they were expecting is not forthcoming. So I am very concerned on the investment front for Africa.

Foreign aid is a concern but as we know my only point there is that foreign aid has fallen far short of what was promised at Gleneagles anyway. They are about – I think the latest calculation is it's about $20 billion short of the Gleneagles promises. So I think we need to make the point that even without a financial crisis, the donor nations are falling short on their promises and I think there may be a cutback in foreign aid but we need to make the point very clearly that drastic cutback would be literally a matter of life and death for many Africans including the two million who are on antiretroviral therapy and relying on aid financed ART for their lives.

Owen Barder
So the private flows you are talking about here are primarily investment flows rather than remittances. It's, this is investment by banks and international companies mainly in infrastructure in Africa?

Shanta Devarajan

Exactly, exactly.

Owen Barder
And how much of that is there in the least developed countries? Is most of that going to the better off countries in sub-Saharan Africa like South Africa?

Shanta Devarajan
Yeah, a large part is going to South Africa but it's actually become much more diverse now. Kenya, Tanzania, Ghana, Nigeria have been recipients of these private capital flows in the last three or four years which is a significant development. Traditionally it used to go just to South Africa. By the way, I forgot to mention Zambia as well. Some of it is as a result of mineral, the possibility of mineral exports but also some of it has gone for all the much needed infrastructure development in sub-Saharan Africa.

Owen Barder
And what about flows of remittances, are they, A, have they been a big part of private flows to Africa and B, do you see those being affected by the financial crisis?

Shanta Devarajan
Yeah, remittances also have been rising quite rapidly. I think the estimates are something of the order of $12 billion a year going to Africa. And they are likely to decline, just because unlike previous financial crises, this is one that started in developed countries. So traditionally remittances have been counter cyclical so that when one of the receiving countries goes into a downslide, remittances actually increase. But in this case, the source of remittances is where the crisis is occurring. And so we are a little concerned about that. We have been monitoring the situation and there are signs say in Kenya of a decline in remittances, and the shilling has depreciated almost in response to that, Cape Verde is another country that's suffering a decline in remittances. But it's too soon to tell by how much this will be affected.

Owen Barder
And on the investment flows is there something that the international community can do, either the World Bank or perhaps the private financing part of the World Bank which is called the IFC? Is there something they can do to make sure that those investment flows don't dry up in developing countries?

Shanta Devarajan
Yes, we are exploring a variety of options. One of which is that these are low income countries and so they are already receiving aid from – or low-interest loans from World Bank under the IDA program, so we can't add to that, because that's money that's already been committed. But there is a possibility that if there is a very good investment project, say an infrastructure project in Kenya or Tanzania, and their private financing has dried up but the World Bank could use it's hard loan, the IBRD window, which is the money that it usually lends to middle-income countries to finance what are called enclave projects, in other words that's higher interest loans but just for that project and the money then is repaid from the returns of that project.

Owen Barder
So these would have to be projects that have their own revenue. So if it was a –

Shanta Devarajan
Right.

Owen Barder
An electricity project where you could charge the users of electricity?

Shanta Devarajan
That's right. Typically they have an export potential as well or they lead to a better or a higher exports then those export revenues could be part of the repayment. But there are ways and it doesn't have to be a direct link to the project. There are ways to earmark associated government revenues or from the project to make

sure that the money is repaid. But again these are, we are exploring these options going on, we haven't decided on anything yet.

Owen Barder
But let's be clear this would mean that the government in the country concerned would have to issue a guarantee for the loan and would be required to repay it at something like commercial rates, sometime in the future.

Shanta Devarajan
That's right. I mean, what we are doing is replacing what the government would have to pay back for the private capital flow. So private capital flows are also going in at commercial rates, if not higher.

Owen Barder
Right, right.

Shanta Devarajan
And in fact the IBRD rates are going to be a little bit lower, about three quarters of a percentage point lower if we are able to do this.

Owen Barder
We talked last week with Ngaire Woods about the role of the IMF and we were speculating about why it hadn't played much role in the crisis. Since then it's been quite active in providing emergency loans in places like Hungary and Ukraine and I think in Iceland and it's announced a new facility, the short-term liquidity facility. But that's only going to be available to countries with a very good track record and one of the conditions for that is that they have low levels of debt.

So the international financial system seems to be getting its act together for the emerging economies. But do you think we need something equivalent to enable the poorest countries to take out effectively balanced payments support loans?

Shanta Devarajan
Well, we would need that if we felt that those countries, these poorest countries are going to suffer a sudden bounce of payment shortage. But part of the reason - because they are not so integrated into the global capital markets, this crisis, for good or ill, is not going to affect the lowest – lower income countries the same way it's affecting these emerging market economies. There isn't a whole lot of capital flows other than these private investment flow from say, Ghana or Kenya to developed countries whereas the Eastern European countries for instance are very closely integrated with Western Europe. So I think it is still necessary to be ready, should some of these countries face a bounce of payments crisis. But I think the crisis is not going to come from capital flows or capital flight but rather from some of the commodity price shops.

So we are also monitoring that situation closely because as you may have observed in that podcast, commodity prices have stated falling particularly oil prices have started falling and for some – for the oil importing companies obviously this is a good thing, it's going to benefit their bounce of payment situation. But for oil exporting countries, they are going to lose, and the mineral exporting countries they are going to lose quite a lot of revenue that they would otherwise have gotten.

Owen Barder
Since we've moved on to commodity prices, should we talk about the food crisis?

Shanta Devarajan
Yeah.

Owen Barder
You may recall that before the main collapse in the financial markets, there was a lot of concern about rising food prices around the world. There were riots in places like Burkina Faso, Cameroon, Senegal and

the protestors were burning food stores in West Bengal and there are lots of explanations for what had happened, some of which now seem quite dated. There was a lot of talk about the effect of the rise of the price of oil, talk about the rapid growth in emerging economies, especially in China as explanations for why food prices had risen so sharply and some people were saying that it was because of the increasing use of bio-fuels. But there was a general agreement that the rich countries should do more to tackle the food crisis partly in their own backyard to get rid of agricultural price supports, getting rid of subsidies and tariffs on food and also to invest more in agricultural technologies to increase food production.

Now we are hearing a lot less today about the food crisis I think mainly because the financial crisis is so much in the news. But here in Ethiopia, for example, there is still about five million people in need of assistance and at least another 10 million in the region in the Horn of Africa. So, Shanta, with prospects for rapid economic growth around the world receding, oil prices now coming down to around $60 a barrel, is there still a food crisis and should the donors be doing more to tackle it?

Shanta Devarajan
Well first of all as you've noted, food prices have started falling and that's not just because of the declining demand, but also that harvests have been exceptionally good worldwide, including countries like Ukraine and Australia, which are large grain and cereal producers. So we have observed a decline in food prices although Ethiopia is a particular case because they have had their own sort of localized food crisis in addition to the global food prices because not only did prices go up but there was a severe food shortage, but it is localized in countries like Ethiopia rather than the global food crisis.

So I think there has been some abatement of the problem. In addition, I think it's fair to say that most African countries have responded by accelerating food production in different ways, mainly by making sure that the other constraints to food production such as infrastructure, fertilizer access and so on are relaxed. This is a medium-term project, but they are beginning to register some gains already. Because it would have been a shame that after food prices declining over the last 10 to 15 years, if the one time when food prices went up that African farmers, who had been losing income over this period, couldn't benefit from it. And I think we have managed to generate at least a modicum of the supply response in Africa and again the rains have helped. So the harvest has been good in order that we can create a virtual cycle where agricultural growth might begin to take off with something like 10 countries in Africa have now had 5% agricultural production growth over the last five years.

Owen Barder
You are saying there has already been a supply response that African countries have been able to tackle what, infrastructure constraints, constraints on ports or railways or…

Shanta Devarajan
There has been a supply response. Now as I said, the supply response is due to a variety of factors, one of which is the rains. Rainfall and that has been extremely good. But also there have been efforts to try to relax some of the other constraints including fertilizer, the fertilizer prices have gone up as a result of oil prices going up. And some African countries have tried to either reduce taxes, import tariffs on fertilizer or subsidize it as well and much of the World Bank's response under this emergency food price response program has been to try to help these countries actually generate that kind of supply response.

Owen Barder
This is the new deal on the global food policy, is it, which is supposed to provide short-term help through safety nets for the vulnerable, medium-term supply responses and longer-term working on things like trade to reduce trade barriers?

Shanta Devarajan
Exactly. And we are accelerating our lending in agriculture. I think the plan is to lend them up to about $1 billion in agriculture to Africa over the next year or two.

Owen Barder

And is that program and the rest of the donor response so far an adequate response to the challenge of food prices? It's striking to me that we became interested in this when donor countries saw prices rising in their own supermarkets, their own consumers were having to pay more for food and were beginning to complain about it and suddenly the donors took an interest in agricultural production, which arguably they have neglected for a number of years.

Shanta Devarajan
Well, no, I think there are a variety of factors. Even before those prices started rising in the supermarkets here, pricing were rising in Maputo and Ouagadougou and people were rioting in the streets and that actually, I think, was much more of a wake-up call, than noticing your bread prices going up in Washington or London. But on the other hand I think there has also been a concern about the declining agricultural productivity or stagnant agricultural productivity in Africa for a long time. And the world development report of last year – well it's 2008 but it came out last year. Identified that agricultural productivity can be one of the most powerful weapons in the fight against poverty and if we could just accelerate agricultural productivity growth in Africa, it would do something like four or five times as much as general economic growth for reducing poverty for the obvious reason that 70, 80% of the poor get their income from agriculture in Africa.

Owen Barder
So overall, overall you are optimistic about the food crisis and the response to it. But I am detecting quite a bit of pessimism in the overall picture of the developing countries as a result of the global economic slowdown that's now expected following the financial crisis, is that right?

Shanta Devarajan
Yeah. I think that's a fair statement although I – again we are coming back to the financial crisis, I would say that while I am pessimistic or I am concerned about some of the warning signs in Africa, Africa's growth would probably be less reduced than that of other countries or other regions. We're in the process of recalibrating a growth forecast for 2008 as well as 2009 and I think that the original forecast, which is about 6.1 or two percent, 6.2% growth, will probably be reduced by about half a percentage point to about 5.7 or so. Whereas in other regions like as in Eastern Europe or even in Asia they are would be some, the growth forecast about one to 1.5% percentage points. So, ironically, because of Africa's lack of integration in – with global capital market they may actually suffer less in this particular financial crisis, but they will suffer somewhat.

Let me just mention one other point which we didn't come up in the financial crisis, which was that quite independently of the financial crisis, there are several African countries that are facing macroeconomic imbalances, Ethiopia being perhaps one of the more important ones with inflation as you probably know hitting at about 60% and Ghana's fiscal deficit is about 10% of GDP, South Africa's current account deficit is close to 8% of GDP, these are serious macroeconomic imbalances. As I said, not – they were not caused by the financial crisis, but they need to be addressed and they are very important to avoid a hard landing, meaning that the one thing we have learned from macroeconomic imbalances is that the longer you postpone adjusting them, the harder is the landing.

Owen Barder
And what kind of measures will developing countries need to take to adjust? Is this a prescription of the 1980s structure adjustment policy or has thinking moved on now about how a country would adjust to, for example, the inflation rate of 60% that we have here in Ethiopia?

Shanta Devarajan
Well, I think some of the basic macroeconomic principles of the 1980s are still appropriate but I think we also need to do two things. One is the same, we don't apply the same policy across the board and also look at the cause of the problem and try to address it at its source. So, for instance, in the Ethiopian case some significant part of that inflation is caused by rising food and oil prices. So to the extent that those are now abating there would be some automatic adjustments but some of that is probably due to monitory expansion and so there may need to be some monetary contraction, raising interest rates which I gather the Ethiopian authorities have already started doing.

Similarly in South Africa they will probably, if the current account deposit which by the way is financed almost exclusively by private capital flows. So if the current account deficit has to be reduced because the private capital flows have declined and there isn't that much domestic or other sources of financing, then the rand would have to depreciate and then, in fact, again that has already started, the rand has depreciated about 20% over the last few months.

So those kinds of adjustments really have to take place. I am afraid that some macroeconomic principles just don't go away. We're faced with these; the money supply still has an effect on inflation, the real exchange does have an effect on the current account and vice versa. Fiscal deficits do lead to higher, either higher interest rates or higher inflation or reduced flow.

[Music]

Owen Barder
On the 20th of October the Mo Ibrahim Prize for achievement in African leadership was awarded to Festus Mogae the former president of Botswana. This is the largest prize in the world consisting of $5 million over 10 years and then $200,000 a year for life after that. The prize is awarded to a democratically elected head of state from a country in sub-Saharan Africa who has served their term in office. Shanta do you think President Mogae deserved this award?

Shanta Devarajan
Oh, I think definitely he deserves the award. The point is, of course, I think as some people have said, this award is not considered to be an incentive for African leaders to leave office and collect the prize as much as a way of giving recognition and high profile to the issue of governance of good governance in Africa. And I think Mo Ibrahim should be congratulated for having put good governance on the map with a highly visible, high profile award and I think the way in which the award winners are chosen with an impeccable board of selectors has really kept it at the right level for the profile it deserves.

Owen Barder
Right, Mo Ibrahim has said that his intention is to draw attention to good leaders in Africa. He said that he wants to hear people say, 'who is Festus Mogae?' Like last year people said, 'who is Chissano?' Referring to the former President of Mozambique who stepped down peacefully and he has observed that everybody knows who Robert Mugabe is but no one knows who the better leaders in Africa are like Chissano and Mogae.

Shanta Devarajan
Yeah that, but it's also giving a profile to good leadership not just good leaders, but it tells you how important it is to have good leadership in Africa. For instance, the latest report by the World Commission identified various factors that gave rise to countries going at, I think, over 8% of GDP over a 20-year period and the consistent pattern of good leadership matters. Leadership with that strategic vision is what seems to distinguish the fast growing countries from the slower growing countries. And so I think the other factor that Mr. Ibrahim is awarded doing is just putting the spotlight on leadership.

Owen Barder
And is it your sense that leadership in Africa is improving?

Shanta Devarajan
Well, yes, I would say just it depends on sort of how long the horizon you take but I think we have had 20-plus years of fairly widespread democracy in Africa. We have had peaceful changes of government and even a party in a large number of countries including countries where you previously there was a single leader for a 20-year period or so such as Zambia, or Côte d'Ivoire and so on. So there I think it maybe too soon to tell whether there's been a systematic improvement in good leadership but at least I am getting the sense that the will of the people is being reflected in the leadership on a more regular and consistent basis in Africa than it, it used to be.

[Music]

Owen Barder
Let's turn now to an announcement of a free trade area in Africa. On the 22nd of October, heads of state and foreign ministers from the three largest African regional economic blocks agreed to work together towards establishing a free trade area which when complete will extend from Cairo to Cape Town. The three blocks are SADC, the Southern African Development Community, COMESA which is the Common Market for East and Southern Africa and the EAC which is the East African Community. I asked Sheila Page at the Overseas Development Institute to tell us what was agreed in Kampala?

Sheila Page
It's actually quite big. They agreed to have a timeline for a roadmap. In other words they agreed to start talks about talks, which is all you can really expect because a group of presidents aren't going to get into detailed discussions of tariff lines. It was interesting because it was more than they were expected to agree and normally with summits like this the communiqué is written in advance. Everyone knows what's going to be in it, and this came out of the meeting as far as one can see.

Owen Barder
So let's just be clear. We are talking now about three of the regional economic communities RECs as I call that and there are, what, eight different RECs in Africa?

Sheila Page
At least. Depends which – how you count them but what's interesting about these three is the overlap among them. Some members of COMESA are also members of SADC. All members of the EAC are also members of COMESA. And at least one of the members of the EAC used to be a member of SADC Tanzania. So these are countries that have worked together within each of the groups and where the groups have had to be aware of each other and have had to coordinate with each other, well, for 15 years.

Owen Barder
So each of these different groups has its own free trade area at the moment, and what they have agreed to do is come together into a combined free trade area for all 26 countries. Is that right?

Sheila Page
Not so fast. Each of the three areas has plans for a free trade area within itself with some exceptions and various delays and stagings. Each of them also has at least talks about going beyond that to a customs union which means not only free trade but the same tariffs on their trade with the rest of the world. Each of them already has some special provisions for trade with members of the others. So to some extent what they are proposing is to make an extremely complicated system simpler.

Owen Barder
And is that an important thing to do? Is this, how big a step forward will it be if they succeed?

Sheila Page
It's a big step. But it actually interested me more in their statement was that they talked about building trade infrastructure as well as reducing tariffs. And that could actually be much more important. Because for most of these countries their maximum tariffs now are down to 20-25% run a lot of things that are lower than that. Whereas the actual costs in terms of administrative requirements of having common standards and the rules for whether a lorry can cross a border or not, these add a lot more than 20% to the costs. And of course poor roads, poor airports add even more to the cost. So if they could get those costs down through a regional initiative that actually would be extremely important.

Owen Barder
And are there any particular countries that will lose overall as a result of this or will it – will every country contain some winners and some losers?

Sheila Page

Probably every country will have some winners and losers. In broad terms this type of agreement is most important for landlocked countries, or countries that have to ship through a member of even their own trade group, at worst one of the other trade groups and therefore deal with two or three lots of customs and tariffs along the way.

Owen Barder
Was Kampala a big step forward or was this just a political statement of intent that is or might be to be followed up in practice?

Sheila Page
I think it will be followed up and I think it was a step forward because it wasn't something which the trade ministers had put in because you need to have something in a statement at the end of the summit. The president added it, they are asking for action by the trade ministers. And I think what is puzzling is why it's happening now because it was a logical step at the time they were negotiating with the EU but the EU negotiations are over. It would have been a logical step to come together and have a common position in the Doha negotiations but for practical purposes those are over. So it is – wasn't quite clear to me why they wanted to do it now, which in a sense makes it more likely that they are doing it seriously and for internal reasons not just because of some external pressure.

Owen Barder
Sheila Page, thanks for joining us on Development Drums.

[Music]

Owen Barder
Shanta this free trade area would encompass 26 countries with over 500 million people and an annual income of over $600 billion a year. But African leaders have been talking about building an African economic community or at least since the Treaty of Abuja back in 1991. How important do you think it is, this agreement that they have reached in Kampala?

Shanta Devarajan
Well it's an important step in the direction of creating a free trade area. I mean, as Sheila Page herself said, this is an agreement to talk about talks. And so with that we haven't yet seen the free trade agreement. But it's an important step in that direction. But I think the more important issue for me is that the benefits of a free trade area are while they may be significant actually pale in comparison to the benefits of regional cooperation in areas such as infrastructure and logistics. And what we find is that free trade areas, the pure trade benefits have to do with the lower tariffs and the common external tariffs of these countries. But as Sheila herself pointed out these tariffs were already fairly low to begin with, so there might be some benefits in lowering them further and generating greater synergies across these countries.

But there's still a real problem about regional cooperation on roads and rails, railways. They are having trouble just getting a railway going, say from Lusaka to Dar es Salaam to be able to get some of these experts out. And quite often the problem is that the rail from Zambia has a different grade than the rail from Tanzania and trying to get these people to coordinate on those can be very difficult. The other big area is potential cooperation on energy. When you have countries or parts of countries such as DR of Congo which has very rich energy sources. DR of Congo has some significant number of hydro power resources of Africa and yet the beneficiaries of this could be or the purchasers of this could be all over the continent.

Owen Barder
Right.

Shanta Devarajan
But we need to get an agreement about power lines, grid lines and pricing of infrastructure. So I think the big ticket item is infrastructure cooperation. And regional economic communities of infrastructure and to the extent that a free trade agreement could facilitate regional cooperation and infrastructure I think that could be a big benefit.

Owen Barder
So you are in the camp with I guess most people who know a lot about this, which includes Sheila as well, that says that it really isn't the tariffs and quotas and subsidies that prevent the poorest countries from trading either with each other or with the rich world but problems of infrastructure of standards. So it's behind the border obstacles that most need to be overcome if countries are going to trade their way out of poverty.

Shanta Devarajan
Oh yeah, I'm definitely in that camp, just because I observe what's going on. I mean these African countries have been with lower in tariffs and quotas. And yet trade really hasn't taken off. In fact Africa's share of world trade is actually lower now than it was 20 years ago. So and then you look at what really is going on and we talk to people and we realize that it takes eight days to clear a shipment out of Dar es Salaam or eleven days to clear a shipment out of Mombasa Port. And then there are huge, very lucrative ports like the Port of Lome and Togo that are completely underutilized because of poor governance problems in those, in the management of the port. These are the big, big ticket items that we are missing, that we are lacking in Africa. And so again I turn this around into an optimistic view. But if you can fix those problems the potential for Africa is limitless.

Owen Barder
What an excellent note to end our discussion on. That's all for this week's edition of Development Drums. Thank you to Shanta Devarajan, you've been very optimistic and upbeat about Africa's prospects. You can read Shanta's blog about Africa at africacan.worldbank.org and to Sheila Page of the Overseas Development Institute at www.odi.org.uk.

You can find those links and links to everything we've talked about today at developmentdrums.org. Please go there and tell us what you think about today's show. Until next time, thank you very much for listening.

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