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for a Stronger Africa:
A New Era, a New Strategy

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Better Global Governance for a Stronger Africa: a New Era, a New Strategy¹

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Abstract

While African countries have made substantial progress over the past two decades, characterized by higher growth and modest improvements in social and human development, they still face great challenges. These include high and stubborn levels of poverty, rising youth unemployment, structural fiscal imbalances and dependence on external financial assistance, heavily concentrated production and trade implying high vulnerability to shocks. Policy recommendations to handle these challenges have typically focused on what African countries themselves – or with the support from their development partners – should do to improve the continent’s economic fate. Less attention has been devoted to the role of global governance in addressing these challenges. Yet, features of the global governance architecture that undermine national policy and international cooperation continue to hamper efforts at the national, bilateral, and multilateral levels aimed at finding solutions to these development challenges. This paper discusses these issues and provides some policy suggestions.

Key Words: Africa; global governance; global trading system; global financial system.

JEL Classification: F62; O55; 019

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Introduction

Economic news on Africa has been quite positive, and increasingly so, over the past decade. African economies have posted impressive growth rates, even weathering the global financial and economic crisis, and some are currently ranked among the fastest growing economies in the world (IMF, 2014). The continent has the second highest growth rate after Asia (Brixiova and Ndikumana, 2013). It has also experienced an improvement in governance, with the majority of countries embarking on democratic changes, forging ahead toward egalitarian representation, including along gender dimensions, and regular universal elections.

These recent positive developments notwithstanding, the majority of African countries still confront major structural challenges that hamper progress towards stable and inclusive development. The continent confronts high and stubborn poverty rates where a large fraction of the population chronically struggles to make ends meet. Sub-Saharan Africa is the only continent where the number of poor people has continued to rise even during the era of growth resurgence.¹ In addition to high levels of poverty, African countries also face high and often rising inequality, both in its vertical (income inequality) and horizontal dimensions (e.g., regional and gender inequalities), which implies that the gains from growth are not equally shared among the population. One of the emerging challenges in African countries is rising youth unemployment, which poses severe political risks as was demonstrated by the Arab Spring in 2011. Unfortunately it does not appear as though African governments are equipped to deal with this rising tide. Few countries have dedicated government institutions mandated and equipped to design and implement explicit strategies to solve the youth unemployment problem.

Structurally, most African economies still lack resilience, with trade and growth remaining concentrated in one or a few products in the primary sector. Growth has not been accompanied by meaningful diversification and economic transformation. The chance for African countries to modernize is highly contingent upon their ability to transform, and especially to better harness their natural resource endowment (UNECA, 2013). One of the challenges facing African countries is that the global environment is rather unfriendly, and it hampers their efforts to gainfully tap into global markets.

Moreover, African economies are hampered by structural fiscal fragility. They still depend heavily on external assistance. Domestic revenue mobilization is substantially below potential and progress in this area is very slow. Weak revenue performance is a severe constraint on efforts to achieve strong, sustained, and shared growth.

The recommendations that are given to handle these challenges have typically focused on what African countries themselves should do to improve their positions, and what their development partners or donors should do to improve the continent's economic fate. Much less attention has been devoted to the role of global governance in addressing these challenges. Efforts at the national, bilateral, and multilateral levels are hampered by features of the global governance architecture that undermine national policy and international cooperation. This paper discusses these issues as a way of shedding light on possible solutions to help put African countries on a more robust development path and thus build a stronger Africa.

The increasing interdependence among countries

That we live in an increasingly interdependent world is not a controversial statement. The performance of national economies is substantially and increasingly influenced and constrained

by outcomes of policy decisions and shocks originating in other countries and regions. This was clearly demonstrated in 2008-09. Unlike in the past, African countries suffered the consequences of a crisis that was not of their own making. What started off as a crisis in the US financial system had substantial spillover effects on African economies. While African countries were able to avoid the first-round effects, due to their limited financial development and limited integration in global financial markets, they suffered second-round effects through the decline in demand and prices for their commodity exports and a collapse in trade financing. They later suffered third-round effects when the banking sector was affected by high exposure to the oil sector in some countries. This was especially the case in Nigeria where a dozen of banks had to be bailed out by the Central Bank (Brixiova and Ndikumana, 2013).

The effects of the recent debt crisis in Europe are another illustration of the relevance of increasing global interconnectedness for African economies. The crisis has affected Africa's trade, given that European countries remain the continent's main trading partners despite the increasing shares of China and other emerging economies (African Union and UNECA, 2012). This also illustrates the risks of African economies' highly concentrated trade and the urgent need to diversify export and import markets.

What is the relevance of global governance in a context of increasing global economic interdependence? The increasing interconnectedness implies that African countries suffer the consequences of governance failures that occur in other regions or at the global level. As indicated earlier, the negative impacts of deregulation and reckless risk taking in the US financial system were not limited to the United States but affected African economies. More generally, inadequate financial regulation policies have detrimental effects on African countries. And yet African countries have no say about global rules on financial sector regulation.

Asymmetries in the global system

Globalization is characterized by important asymmetries that have substantial implications for African economies.

Trade and finance

The first main manifestation of asymmetries is with regard to the governance of trade and finance. The past decades have witnessed rapid expansion of financial flows in all forms, including foreign direct investment, portfolio flows, and cross-border mergers and acquisitions. This expansion has been facilitated by financial liberalization and deregulation at the national level, as well as the proliferation and rapid growth of offshore finance. Finance has outpaced trade in goods in size, scope, and sophistication over the past decades. Between 1980 and 2012, capital flows grew five times faster than exports. Global trade in merchandise increased by 820 percent, from US\$1,979 billion to US\$18,214 billion, while global outward foreign direct investment increased by 5,290 percent, from US\$549 billion to US\$23,593 billion.² Most capital flows have been directed to the services sector, including banking (UNCTAD et al., 2002, p. 9). The key concern regarding this asymmetry is that while there have been substantial efforts to establish and strengthen global frameworks for the regulation of trade in goods, little attention has been devoted to the regulation of finance.

Inadequate governance of finance has substantial implications for African economies in many important ways. The rise in unregulated financial flows increases the fragility of national and regional financial systems through higher contagion across the globe. Globalization and unregulated finance have also facilitated the expansion of capital flight and illicit financial flows from African countries. Over the last four decades, up to 2010, Africa lost about US\$1.3 trillion

through capital flight or US\$1.7 trillion including interest earnings. This amount vastly exceeds the continent's liabilities to the rest of the world, thus ironically making the most capital-starved continent a net creditor to the rest of the world (Ndikumana and Boyce, 2011, 2013; Ndikumana et al., 2014). Illicit financial flows imply substantial losses in public and private capital as well as government tax revenue, retarding growth, poverty reduction, and economic development in general (Ndikumana, 2014c; Nkurunziza, 2012, 2014). Indeed, a large proportion of illicit financial flows are motivated by tax evasion and tax avoidance.

An important mechanism of illicit financial flows is transfer pricing by multinational corporations, especially in the natural resource sector. This is facilitated by the increasing sophistication and complexity of the governance and ownership structure and domiciliation of modern large corporations along with the lack of coordination of tax policies around the world. For example, while the copper mining giant Mopani Copper Mines (MCM) is a Zambian registered company, it is almost entirely located in tax havens: it is 73 percent owned by Carlisa Investments in the British Virgin Islands, a company that in turn is 82 percent owned by Bermuda-based Glencore Finance, which is 100 percent owned by Switzerland-based Glencore International AG. This complex structure enables MCM to minimize its tax liabilities in Zambia by inflating its costs, the bulk of which are expenses paid to company affiliates located in low-tax jurisdictions. Such mechanisms explain why Zambia is generating tax revenue from the mining sector that is far below its potential. A report from the Zambia Institute for Policy Analysis and Research says it all: "With some of the worst poverty statistics in Africa, Zambia appears to have little to show for a century of mining" (Manley, 2013). Most noteworthy, an analysis of reports by the Extractive Industry Transparency Initiative (EITI) reveals that the

largest tax payments by mining companies consist of employee taxes or PAYE (pay-as-you-earn) taxes while corporate profit taxes contribute a relatively small share (Lundstøl et al., 2013).

The foregoing discussion has important implications for global governance. A long-standing tradition of governance of global trade in merchandise has led to the establishment of international bodies in charge of regulating international trade. In addition to global institutions such as the World Trade Organization (WTO), there are regional arrangements such as the North American Free Trade Agreement (NAFTA) that aim to coordinate trade for the purpose of development and stability of the global economy.

There is no equivalent structure for the governance of global finance. On the contrary, past decades have witnessed an increasing deregulation of finance with accompanying negative effects on financial stability. The liberalization era saw the proliferation of offshore financial centers (OFCs), which are the ultimate illustration not of only lack of regulation but also of blatant violation of responsible-finance rules. Contrary to common perceptions these OFCs, also referred to as “safe havens,” not only include exotic tropical islands such as the Bahamas, Cayman Islands, and the like, but also large financial centers such as New York, London, and Paris.

The positive implication is that because these OFCs are located in countries with otherwise strong legal and regulatory systems, it is possible to discipline them given adequate political will. Indeed, things are beginning to move gradually in the right direction. For example, some progress has been made recently by the United States in breaking through the secrecy walls of Swiss banks, forcing them to report assets held by American taxpayers. The question is how

African countries can jump on the bandwagon, given that they have no muscles to flex in front of well-capitalized and politically powerful financial institutions in OFCs.

Regulating global finance requires addressing weaknesses and systemic issues at both the national and international levels. At the national level the key issues to tackle are transparency and accountability in trade and capital account transactions. This includes tackling import and export misinvoicing, which constitutes an important channel of capital flight. There is an urgent need to clamp down on tax evasion and tax avoidance by multinational corporations. But, at the same time, African governments need to be more diligent in their design of tax incentives aimed at attracting foreign direct investment. In addition to being subject to corruption, these incentive schemes are often exaggerated, granting multi-year tax holidays to companies that are investing in sectors that are otherwise highly profitable with relatively short break-even cycles. In addition to causing large losses in tax revenue, such generous tax holidays imply significant competitive advantage in favor of foreign investors to the detriment of domestic investors.

At the international level, governance reforms are needed to establish and strengthen mechanisms for exchange of information on cross-border trade and financial transactions. Specifically, advanced countries and global governance bodies need to institutionalize automatic exchange of information and country-by-country reporting of multinational corporations' trade and financial operations. These measures will not only benefit African countries but also help build much cleaner, development-oriented global trading and financial systems.

Labor and capital movements

The second type of asymmetry in the global economic system is with regard to the movement of labor and capital. Globalization has been accompanied by increasing capital mobility partly as a

result of deregulation, as illustrated by the explosion of financial flows. Comparatively fewer changes have taken place with regard to labor mobility, as labor remains more strictly regulated than capital. It is true that migration has increased, including rising shares of highly skilled labor from Africa, which implies substantial losses in the continent's human capital. This is especially relevant given that education is mostly financed by governments.³

The implication of these asymmetries between capital and labor mobility is that the tax burden falls disproportionately on labor compared to capital. The above example of the Zambian mining sector is quite illuminating in this respect: increased capital mobility favors capital owners relative to workers, and large companies relative to small and medium enterprises (SMEs), so the working class and SMEs end up bearing a tax burden that is larger relative to their incomes. The taxes paid by workers and SMEs are used in part to cover the tax holidays granted to large foreign investors. As a result, income inequalities deepen, while the provision of public infrastructure and social services is held back. This too affects workers proportionately more than capitalists, who can afford private services in or outside the country.

Implications for global governance

What are the implications for global governance? An aspect that we emphasize in this paper is the implications for global development finance. As discussed above, increased capital mobility has been accompanied by large and increasing losses in tax revenue for African countries. The evidence requires a deep rethinking of development assistance strategies. Traditionally, the focus has been on efforts to increase official development aid and facilitate access to markets for African countries. But as we know by now, aid volumes will not increase meaningfully in the foreseeable future.

It is therefore time to shift the focus towards helping African countries to mobilize more of their own domestic resources.⁴ This involves assisting these countries to expand their tax base, including bringing into the tax net the growing urban real estate sector.⁵ It also involves increasing the transparency and user friendliness of tax systems, as well as building investigative skills and an appropriate administration infrastructure to track and prosecute tax evasion. Most importantly, the donor community can help African countries by enforcing responsible behavior by multinational corporations. This involves enforcing the existing rules against corporate corruption, such as the US Dodd-Frank Act and the UK Bribery Act.⁶ The ultimate objective is for African countries to be in a position to mobilize sufficient resources to finance their development agenda and to graduate from aid.

Global governance and national policy space

For African countries to build stronger and more resilient economies, national development policies need to be designed differently and geared towards building stronger productive capacities. For this to happen, greater country ownership is needed. Two important dimensions are emphasized in this paper.⁷

Macroeconomic policy

First, African countries need to move away from the “do no harm” approach to macroeconomic policy. They need to consider and use macroeconomic policy in active support of national development strategies, beyond the traditional confines of macroeconomic stabilization. Traditionally, African countries have been trapped into a minimalist approach that confines the role of macroeconomic policy to keeping inflation at low single-digit level, explicitly at a magic 5 percent.⁸ By setting the bar so low (only focusing on inflation), this policy rewards the few

occasional “stellar performers” that are able to bring down inflation, regardless of the actual progress made in real development outcomes. This is a rather cynical view of policymaking in Africa. Certainly African governments can do better than this.

Broadening the goals of macroeconomic policy also requires broadening the range of its instruments, and increasing the integration and synergies between macroeconomic policies and sectoral strategies. In particular, governments need to leverage the potential of credit policies, inclusive finance strategies, investment incentives, and employment policies in stimulating private investment and employment creation. This will help overcome the trap of jobless growth that many countries have experienced over the past decades of “growth resurgence.”

Industrial policy

The second dimension emphasized here is the need to embrace industrial policy as the cornerstone of national development policies. This requires a philosophical and ideological shift to overcome the negative view of the role of government in economic development. Africa and the global community must come to realize that it is impossible to achieve strong and sustainable development without a capable state.

At the sectoral level, industrial policy in African countries must establish agriculture as the launching pad for manufacturing and industrial development. This involves policies and mechanisms to support agribusiness and other industries for transformation of agricultural products. For example, Ethiopia has made substantial progress in leveraging its large cattle stock to build a growing leather industry. Rwanda, too, is making headway in agro-processing, in the transformation of fruits into juice, processing and packaging of milk, and other agro-industries.

This creates incentives for investment in agriculture, creates jobs, increases and stabilizes export revenue, and reduces dependence on food imports.

Another key element of this renewed industrial policy is to exploit the full potential of the continent's natural resource endowment. This requires measures to move up the value chain in the sector. This will be accomplished by building domestic capacity through explicit human skills development that leverages resource revenues. It also requires clear investment rules that mandate and institutionalize the allocation of revenue from oil and minerals into infrastructure investment and the stimulation of non-resource activities. Botswana is a good example in this regard. It has institutionalized a budgeting rule, that the Sustainable Budget Index—defined as the ratio of non-investment spending to recurrent revenue—must be kept below one (Lange and Wright, 2004). This ensures that all the revenues from mineral resources are used to finance public investment. Botswana is also making efforts to increase the domestic transformation of diamonds, which will help increase the value added of its exports while also creating jobs.

A cornerstone of this renewed industrial policy is technology and innovation. Thus far, African countries have not invested sufficiently in technology and innovation. There are some encouraging trends whereby some governments, for example in Uganda and Ethiopia, are giving more prominence to science, technology, and innovation in their educational systems. Still, services for the development of the industrial sector receive very little public resource allocation.

Global aspects

What is the relevance of global governance? For African countries to successfully embark on a path of economic transformation driven by well-crafted industrial policies, they will need to be given sufficient policy space and ownership of national policies. This requires getting rid of

imported ready-made one-size-fit-all policy packages. They must be given the flexibility to innovate and adapt their national strategies to domestic circumstances and national goals. Advanced countries must also facilitate their access to modern technology, through technology transfers and resistance to protectionism. At the national level, the success of industrial policy requires visionary leadership and confidence, with a view to offer and stand behind an alternative national viewpoint regarding national development policy. In other words, African countries must also be prepared to seize the policy space in the event it is granted to them.

Voice and representation

Traditionally, the global governance architecture has been founded on a very simple principle: economic size is all that matters. Representation at the main international governing bodies is determined by the size of a country's economy. And given that this principle was established a long time ago, it naturally favors old economies, namely those of Europe and North America. Thus, Africa and other developing regions are marginalized in the global decision-making bodies where their fate is usually sealed. It is in that context that Africa has only three seats on the executive board at the World Bank—an ironic feature of an institution whose mission is to promote good governance and economic development. The Bretton Woods institutions' largest client is Africa, which contains 32 of the 48 least developed countries and the largest number of poor people in the developing world excluding China. Yet the continent is inadequately represented in these institutions' policymaking processes. It is indeed ironic that institutions whose mission is to champion good governance are unable to operate on the simple rule of fair representation.

Today global governance is gradually shifting towards elite multilateralism, where deliberations on vital issues are held within small clubs of large economies, thereby marginalizing the traditional more representative bodies such as the United Nations and its affiliated organizations. Major decisions affecting the world economy and African economies in particular are taken at the meetings of the G7, G8, and G20, where African countries are not represented.⁹

What options does Africa have to address this marginalization in global governance? There are three possible courses of action. As a first notional option, the large economies, namely South Africa, Nigeria, Algeria, and Egypt, can choose to lobby the global powers so that they can become members of the elite clubs and defend their own national interests. This would leave the smaller poorer African nations in the dark to fend for themselves. Obviously this is a losing strategy. These countries will have a hard time being accepted in the elite clubs. Moreover, it is impossible to build islands of prosperity in a sea of deprivation.

The second option is for the large African economies to embrace their leadership destiny and champion a unified African voice to defend the continent's interests in the global arena. This involves developing strategic alliances with regions that have similar interests so as to leverage the increasing strength of the "global South." Thus the continent would ride on the rising tide of economic prosperity in the BRICs and other emerging economies. This seems to be a winning strategy.

The third option is to strengthen regional integration. This would enable the continent to develop larger regional markets and build capacity to initiate African solutions to Africa's economic and political problems. The consolidation of regional integration is a powerful strategy for increasing Africa's voice in global governance.

The combination of these last two options is Africa's winning strategy in an increasingly integrated yet marginalizing global economy. It is time for Africa to seize these opportunities and take charge of its economic destiny.

Conclusion

This paper has identified a number of critical issues that characterize the current global governance structure and aspects of globalization that have major implications for Africa's economic development. It has underscored important asymmetries in the globalization process that result in substantial disadvantages for African economies. It has also highlighted the marginalization of the African continent in the current global governance structure, whereby major decisions that have vast implications for Africa's economic destiny are taken in global bodies where Africa is not represented. The paper has laid out a number of options that the continent may pursue to address these challenges so as to better position itself to take advantage of globalization and establish a stronger base for long-term development. The success of these strategies requires visionary leadership on the African side as well as reforms of the global governance system to improve transparency, accountability, and mutual responsibility. Such reforms must be geared toward giving African countries more policy space to own their national policy frameworks so that they are tailored to country-specific circumstances and help achieve national development goals.

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¹ The number of poor African people increased from 205 million in 1981 to 386 million in 2008 (World Bank PovcalNet database).

² Data obtained from UNCTAD's statistical database at <http://unctad.org/en/Pages/Statistics.aspx>.

³ In other words, private human capital is financed by public funds. In many African cases, even private education institutions free-ride on public resources: their teachers are often full-time employees of public schools (resulting in high teacher absenteeism) and use material from their public institutions of affiliation.

⁴ See Ndikumana (2014b) for a detailed discussion and illustrations.

⁵ Rwanda is making progress in taxation of urban real estate through computerization of property records and improved monitoring of tax payments by the local authorities. These reforms are both feasible and highly beneficial.

⁶ See Ndikumana (2013) for a more detailed discussion of anti-private sector corruption rules and regulations.

⁷ See UN-OHRLLS (2013) for an in-depth and illustrated discussion of strategies to build productive capacities in developing countries.

⁸ It is not clear how the 5 percent inflation target came about. Even more intriguingly, it is not clear how it applies to all countries. See Ndikumana (2014a) for a discussion of implications of inflation-focused monetary policy frameworks in African countries.

⁹ South Africa has a seat at the G20 table but in its own right, not as a mandated representative of Africa's interests.