

Bretton Woods Committee
Conference on African Financial Management and Investment
Brookings Institution
April 23, 2004

SUMMARY

Introduction

Executive Director James C. Orr welcomed participants and speakers to the conference and outlined the Bretton Woods Committee's mandate, to increase understanding of the multilateral financial institutions, the World Bank, the African Development Bank, and the International Monetary Fund.

He noted that one theme is common to the developing countries that have reached self-sustaining growth: all possess vibrant private sectors. Two key characteristics of a vibrant private sector are active and solid financial management and climates that are very investment-friendly. He reviewed the objective of this conference, part of a series of ongoing development symposia that seek to examine a small subset of development issues, in an effort to make some headway in the areas of national management and private sector investment.

Rosa Whitaker, President and CEO, The Whitaker Group

Ms. Whitaker offered several insights from her experience with Africa. First, trade and investment are the best vehicles to achieve growth and to diversify Africa's struggling economies; second, Africa's development challenges are certainly immense but not insurmountable.

Whitaker identified two areas of historical slippage that have handicapped the African development cause. The first occurred when the international community did not recognize the critical role that private sector, trade and investment could play in spurring economic development in Africa. The second instance was the design of policies that reinforced Africa's dependency on Western generosity, which led to donor fatigue. In her view, these policies have undermined Africa's ability to attract trade and investment because it is viewed as a continent of impoverished beggars rather than potential trading partners.

There are two keys to ensuring that Africa's natural endowments generate wealth:

- Value-added export promotion and transformation of Africa into an attractive and viable base for the production of intermediate and final goods is crucial;
- Market access: African Growth and Opportunity Act (AGOA) demonstrates the inextricable linkage between market access and trade and investment attraction by removing U.S. tariffs and quotas on practically all Sub-Saharan African products.

The Bretton Woods institutions must move beyond their traditional mandate and intensify their role in opening global markets to Africa by engaging in trade facilitation, Whitaker noted. Several factors are part and parcel of this mandate: the support of development requires support of trade, which in turn requires capacity building, trade facilitation, and bringing in capital for trade.

Whitaker stressed that intensified support and encouragement from the Bretton Woods institutions are critical to attract major investors from Western countries.

Peter Woicke, Vice President, the International Finance Corporation

Mr. Woicke said that while the current global situation demands strict attention to security issues, development and prosperity are key factors in obtaining security, so it is imperative that these issues not lose their place on policymaker's agendas.

Two of the biggest barriers to investment directly related to public finance in Africa are the amount of defensive planning required for a business to respond to unstable macroeconomic management and the high real interest rates on private borrowing that result from excessive domestic borrowing when governments run deficits.

He cited several encouraging signs. For example, numerous countries have been working with rating agencies to put their financial houses in order and to establish sovereign credit ratings. This yields positive effects:

- The establishment of confidence in the marketplace;
- The spurring of other investment flows, in particular other short term credit and even FDI;
- The creation of a global yardstick to assess risk;
- The dispelling of some of the bad press that pervades international opinion on Africa.
- Most important, this process exposes governments, finance ministers and Central Bank governors to the type of evaluation and discipline they can expect from private international financial markets. It brings the power of the markets to bear on issues such as transparency, fiscal responsibility, and monetary prudence.

Woicke discussed investment climate factors and a new IFC research report called "Doing Business." This report contained comparative indicators on key investment climate factors for most countries in the world, and measured actual outcomes in the life cycle of a business, including a broad range of factors such as labor regulations, availability of credit, and requirements to open or to close a business. The fundamental message of the report is that the level of business regulation does matter. Governments do have control over these factors, and are therefore able to make progress on these issues.

Woicke discussed the IFC's activities in Africa and their special focus on infrastructure, small and medium enterprises, and the financial sector. The IFC has also

determined two areas in which there is the opportunity to add significant value, including environmental and social safeguards for complex projects and governance programs for extractive industries.

He addressed the importance of strong technical assistance capacity and outlined IFC efforts to revamp and beef up technical assistance capacity in Africa. Woicke concluded by addressing the issue of the brain drain, a phenomenon in which much of the educated population leaves Africa to live in the U.S. or Europe. While there is no panacea for brain drain, improving social services in Africa will slow the process and will hopefully start the virtuous circle of development.

The Hon. Alan P. Larson, Under Secretary of State for Business, Economic, and Agricultural Affairs

Secretary Larson addressed the keys to African development from the U.S. point of view. He noted the importance of the private sector to African development, citing President Bush's Millennium Challenge Account (MCA) as an example of the Administration's commitment to the augmentation of private sector-led growth in Africa. He highlighted the roles of the World Bank, IDA, and IFC in stimulating medium-sized enterprise initiatives for Africa. All of these initiatives are particularly important to Africa where many countries are in a 0-4% growth range.

Larson described the value of espousing entrepreneurship and cited a report presented by former Ernesto Zedillo to UN Secretary Annan that calls for empowering people to use their creativity and assets to develop better futures and lives for their families, children, and communities. Sustainable growth is also crucial.

The emphasis on the private sector and sustainable growth does not shift or reduce government responsibility. The MCA gives strong consideration to government policy frameworks in deciding where the Millennium Challenge Corporation (MCC) allocates funds.

Some key criteria for the allocation of MCA funds include open governance policies, investment of available resources in initiatives addressing education and healthcare and a climate of economic freedom offering opportunities to citizens.

The Zedillo Report highlights the fact that the assets of poor countries are estimated to be approximately 9 trillion dollars a year, and use of these flows and assets is crucial to the future of developing countries. Also of importance is the reversal of "dead capital," or capital that is not available for economic development.

Micro finance and the strengthening of financial markets are terribly important, and require strong goal setting to ensure that businesses are not just starting up, but expanding and growing. This entails the identification of best practices, pro-finance initiatives, and ensuring that the policy environment is conducive to expansion and growth. This must be accompanied by the strengthening of capital and financial markets so that families are

able to safely save their money in the bank, where it can grow and eventually be used to finance development in their countries.

The MCC has also been focusing on strengthening financial markets in ways that advance social policy objectives, so that borrowing can occur to support, for example, water and sanitation projects or new homes.

On a macro level, the MCC works with countries on their investment climates to build confidence in domestic and international business executives making significant investments and to stop capital flight. This requires an open dialogue between businesses and governments to drive home the point that much more capital could be available from the private sector with an improved policy environment.

Larson concluded by expressing that the MCC anticipates working with countries demonstrably committed to bettering the climate for private sector development and the welfare of their people. Such commitment will go far in securing continued support from the United States government.

Dr. Kwesi Botchwey, Executive Chairman, The African Development Policy Ownership Initiative

Dr. Botchwey noted that this is a time of great opportunity and challenge in Africa. While macroeconomic and trade policies are important, they are not sufficient for growth, which requires a stable macroeconomic environment that provides incentives for savings and investment. Many African countries have tremendous difficulty constructing type of stable macroeconomic environment.

Botchwey said the three pillars to increased investment and sustained growth are a sound macroeconomic environment, infrastructure, both physical and financial, and human resource development, or empowerment.

It is important to recognize that while governments may well be committed to creating a solid macroeconomic environment, they are faced by limitations in national resources. When these resources are not augmented by private flows, macroeconomic management from the inside becomes particularly difficult.

The second key, which has two components, is physical and financial infrastructure (the integrity of the financial system). Following periods of crisis, banks become very risk averse, which hurts small and medium sized enterprises. It takes time to discern ways of getting around this. A crucial element of the financial infrastructure is entrepreneurship.

Another key lies in well-functioning institutions and governance. There has been a significant improvement in governance conditions in most African countries, however that does not necessarily lead to faster growth.

The final key to African growth and opportunity is human resource development of the poor through investments in education and health. Governments must also elicit the participation of citizens in the decisions that affect their lives.

He continued by stating that opportunities lie primarily in trade and in official development assistance. Reduced levels of support for aid programs are what make trade and the successful completion of the Doha round especially important.

Finally, Botchwey addressed the importance of Africa taking responsibility for its own advancement. With regards to capacity building, donors must create a space for the African countries to think for themselves and to use their own understanding of their national situation to create viable solutions.

Bobby Pittman, U.S. Department of the Treasury

Mr. Pittman focused on the effectiveness of grants in Africa. He reviewed President Bush's bold increase in 2001 of the level of grants provided by the MDB's. While demonstrating a strong showing, the future of these initiatives is not certain; three replenishments are due this year (Asian Fund, African Fund, and IDA).

Pittman addressed two broad areas. The first was the effectiveness of funding. Under Secretary Taylor recently organized a trip for Treasury officials to see how grants are working on the ground and to determine whether local officials are coordinating the disbursement of funds to maximize their effectiveness. Local officials indicated that grants could be funneled directly into targeted programs, while loans undergo a very detailed bureaucratic cycle. Pittman indicated that when dealing with the poorest countries in the world, offering loans rather than grants is not a sustainable proposition.

One very positive effect of grants is the "crowding-in effect", which is the drawing in of other donors who are attracted by the additional credibility projects gain by receiving MDB grants.

Expediting the money through the banking system to the countries remains a problem. Officials also noted that the donor community's willingness to offer grants to address issues such as HIV/AIDS and education denotes their true commitment not only to the issues, but also to the government efforts to make positive changes.

Drawing on his recent African trip, Pittman highlighted several key issues pertaining to grants:

- Debt sustainability: when countries assume a grant rather than a loan, the debt ratios are not going to increase;
- Crowding-in effect: while not part of the initial plan, this is obviously very positive;
- Bureaucratic hurdles: grants are far easier to manage than a loan, and reach the destination with a minimum of red tape.

Pittman underscored the main issue going forward. Replenishments are due to be reexamined this year. Advocates of African development must work hard in order to secure the needed funding. Now Africa and the United States are on the same page and ready to work together, he asserted, the momentum that has been gained must not be lost.

Omar Kabbaj, President, The African Development Bank

African Development Bank's main objectives are to become the premier development finance institution on the continent, to reduce poverty, and to achieve sustainable growth. The Millennium Development Goals (MDGs) are essential benchmarks to assessing progress of member countries.

Mr. Kabbaj divided the African countries into four separate groups. The ADB adapts its approach to fit each group's needs.

Group 1 consists of middle-income countries of North Africa, South Africa, and a few others such as Botswana and Mauritius. These countries have achieved reasonably stable and diversified economies, have access to sources of financing, and have attracted significant amounts of FDI. The ADB's strategy with these countries is to build on achievements of the recent past and to help them to become more competitive.

Group 2 consists of approximately 14 countries that have implemented and sustained far-reaching political and economic reforms, including liberalization of political systems, adoption of sound macroeconomic policies, and implementation of structural changes to promote private sector led growth.

Group 3 comprises approximately 13 countries that have implemented similar economic and political reforms, however these reforms have not reached desired levels, specifically institutional and structural reforms for promoting private sector growth.

The strategy for these groups two and three focuses on poverty reduction and promotion of sustainable growth. The priority areas of intervention are agriculture, rural development, education, and health (HIV/AIDS is largest concern). Other areas of intervention include improvement of investment climate and governance, reformation of legal and judicial systems, promotion of environment and gender equality.

Finally, Group 4 countries are either in conflict or emerging from protracted conflicts and have devastated economies. In post-conflict countries, the Bank acts as a key player in helping these countries reengage with the international community and begin the reconstruction of their economies.

The Bank has four fundamental principles:

- Country ownership;
- Greater selectivity;
- Participatory approaches;
- Enhanced cooperation with all development partners.

In addition to the above, the Bank is becoming more of a results-based organization, using a measurement framework to assess projects. The Bank has also decentralized its operations by opening 25 country offices.

Africa will continue to require the assistance of the international donor community through increased development assistance (ODA), debt relief, and trade.