**QUOTE OF THE DAY**

**We first make our habits, and then our habits make us.** – John Dryden (1631 – 1700), English poet, literary critic, translator, and playwright



# Speaking truth to African power

**BUSINESS ANALYSIS**

Frank Vogl

IT'S NO SECRET that corrupt officials and shady Western companies are stealing much of Africa's natural resources wealth from the people. Fortunately, as Frank Vogl explains, we have both a detailed understanding of the problem and the tools to solve it. Will industrialised nations step up to end the practices enabling this abuse?

Infant mortality in oil-rich Nigeria is three times as great as it is in one of the world's poorest countries, Bangladesh.

African resource revenues will grow in the coming years. Failure to act will increase an avoidable disaster.

Social indicators in many of the sub-Sahara African countries endowed with oil, gas and mining wealth are appalling.

Nevertheless, the World Bank, the African Union and many other prominent official organisations have repeatedly avoided the blunt condemnation of the rotten regimes that run so many of these countries. Now that is changing, thanks to well-timed efforts by a group of distinguished international leaders, headed by former UN Secretary General Kofi Annan, and known as the Africa Progress Panel.

The 2013 G8 summit put the issue of global "transparency" on taxes and banking front and centre on the international policy agenda this year.

Separately, Annan's group released a landmark report in June (Africa Progress Report 2013) that also places transparency and accountability front and centre in a forceful call for policy changes in many of Africa's resource-rich countries. The panel's aim is to shine a light on the mounting – and totally avoidable – humanitarian tragedy unfolding in many of sub-Saharan Africa's 20 resource rich nations.

Annan's efforts may well have a significant impact on the G20 summit in Russia next month – particularly on the results of a special summit anti-corruption working group."

Concretely, the G20 is likely to endorse strongly both Annan's call for forceful implementation of new rules to force oil, gas and mining companies to publicly disclose all of their royalty payments to African governments and for tougher anti-money laundering measures.

The panel's report provides extraordinary detail about the criminal activity that traps tens of millions of Africans in absolute poverty. It also outlines the failures of the international official community to address the situation forcefully.

The report concentrates on poverty in those African countries – from Angola to Zimbabwe – that are enjoying rapidly rising incomes from the development of their extractive resources.

In almost all these countries, the report finds that tiny and powerful elites enjoy exceptional wealth, having diverted their nation's mineral riches away from the citizenry. The charges of irresponsibility laid at the feet of many African governments are compelling. The report provides case studies to support its bold assertions, alongside detailed statistics and the kind of forthright language rarely found in major public reports.

The panel argues that: "The haemorrhaging of resource revenues that occurs through secretive deals and the operations of offshore companies is an unconscionable blight on the lives and hopes of their citizens."

It adds: "Africa's resource wealth has bypassed the vast majority of African people and built vast fortunes for a privileged few."

**Workers tend seedlings on a farm in Fundong, Cameroon. Africa's resource wealth has bypassed most African people and built vast fortunes for just a privileged few.** PHOTO: BLOOMBERG

Kofi Annan highlighted the stakes for reclaiming stolen national wealth for the people, observing that "Resource-rich countries in Africa still have some of the worst human development indicators in the world".

Two-thirds of Africa's out-of-school children (a third of the global total) are from resource-rich African states.

"Millions of people suffer debilitating and protracted periods of ill-health because of avoidable diseases."

And he goes on to note that "resource-rich countries probably account for two-thirds of Africa's out-of-school children – one in three of the world's total.

"Social protection systems are underdeveloped. When drought or sickness strikes, the poorest and most vulnerable have no safety net to support them."

Instead, Annan explains, low-income parents "are forced to sell productive assets, cut nutrition and take children out of school, perpetuating the cycle of poverty.

"Smallholder farmers are denied a chance to produce their way out of poverty by the poor state of the production and transport infrastructure."

Analysis in the report shows exactly how national African governments, multinational companies and the governments of leading industrial countries have misappropriated the revenue owed to Africa's poor. In particular, state-owned companies in the extractive industries in many African countries engage in all manner of schemes – from mispricing assets to organising the transfer of assets from the state to powerful elites and outright theft of revenues.

What is needed now is transparency and accountability, with meaningful legislative oversight of these enterprises, comprehensive auditing, full disclosure, for example, of "signature bonuses" for contracts and – to take another common occurrence – "concession trading".

Elites set up offshore firms, commercial secrecy for mining multinational corporations (MNCs) and limit reporting for state firms. As a result of the current opacity, for example, the report notes with regard to the Democratic Republic of the Congo (DRC) "unravelling the deals involved in concession trading in the DRC is enormously difficult.

"The complex structures of interlocking offshore companies, commercial secrecy on the part of major mining companies and limited reporting by state companies creates what amounts to a secret world – a world in which vast fortunes appear to be accumulated at the expense of the DRC's people."

The report also blasts multinational companies. Their overly secretive business structures, aided by complex tax approaches, foil any attempts for governments to promote greater transparency and put in place better regulation, even when they want to.

Hundreds of Western multinational firms involved in concession trading in Africa are registered in traditional tax havens, such as the Cayman Islands, the British Virgin Islands and Bermuda.

Or they are associated with shell companies registered in the UK, or are directed via financial entities in Switzerland and the US.

Forceful enforcement is now needed to ensure that recent legislation on both sides of the Atlantic to strengthen extractive industries' transparency.

Despite the protests of many oil and gas multinational corporations, the G20 could well provide the kind of push for implementation that Annan and his colleagues view as imperative.

The groundwork has been set. The 2010 US Dodd-Frank Financial Reform Act included a clause that compels oil, gas and mining companies to publish full accounts on annual basis of their payments to foreign governments.

Hundreds of Western MNCs in concession trading in Africa are registered in tax havens like the Caymans.

As was to be expected, the industry – never a friend of transparency – is challenging this in the courts.

However, the US Securities and Exchange Commission is determined to implement the new requirements and has called for firms to start reporting in 2014.

Impressed by the US lead, the European parliament in recent months enacted similar legislation, adding transparency in the forestry sector at the same time. The action there will lead to national legislation in the 27-member countries of the EU.

Then the G8 Summit placed curbs on global corporate tax evasion as a top priority for action. This dovetails with the recommendations made by the African Progress Panel. The G20 is most likely to endorse the G8 action and strengthen the drive to act.

> There is a need for a bold set of initiatives to explicitly tackle the corruption in many African countries that is a major cause of absolute poverty and mounting income inequality.

If the most powerful industrial countries take steps to curb tax evasion and the use of opaque holding companies by multinational resource extraction firms and by their African business partners (often in government positions) it would do much to benefit African citizens.

But international actions alone are not sufficient. Too many African governments seem impervious to calls to be more accountable and to better disclose just what happens to the revenues they obtain from the extractive sectors.

What can change this situation?

To a modest degree, the exposure of the flagrant abuses of some African government leaders and their cronies can help.

Court actions in France and US Senate investigations have brought to light vast luxury investments held in France and the US in the names of some African leaders and members of their families.

To a modest degree, exposing flagrant abuses of some African leaders and their cronies can help.

More importantly, Western governments could start to force banking institutions to implement existing "know your customer" rules.

These would compel African leaders to demonstrate how they obtained their fortunes and on what basis the cash is rightly their own.

At the same time, these Western governments should streamline procedures to ensure that stolen assets – deposited in banks in Switzerland, Luxembourg, Austria, the United Kingdom and other locations – are repatriated swiftly and effectively.

There is a need for a bold set of initiatives to explicitly tackle the corruption in many African countries that is a major cause of absolute poverty and mounting income inequality.

The World Bank's President, Jim Yong Kim, recently pledged to dedicate his institution's work to ending extreme poverty by 2030. But in announcing this goal, he made scant reference to the massive malfeasance that is such a cause of this poverty.

It is time that he led the charge, inspired now by the arguments made by Annan and his colleagues. Reform is more urgent than ever. The coming years are most likely to see increasing investments and revenues in the natural resources sectors of Africa.

This provides an enormous opportunity to use the new wealth to address critical development issues. Failure to move fast will increase an avoidable humanitarian disaster. In few parts of the world is the population rising as rapidly as in sub-Saharan Africa – from 670 million in 2000 to an estimated 1.2 billion by 2025 and then to 2 billion by 2050.

*Frank Vogl is the author of Waging War on Corruption – Inside the Movement Fighting the Abuse of Power. You can read a Globalist Bookshelf excerpt here.*

# Fed speak exposes SA economic fragility

**RECOVERY AT RISK**

Arthur Kamp

SOUTH AFRICA'S post-recession economic recovery is built on fragile foundations, leaving it vulnerable to unfavourable global developments – most notably unexpected increases in global risk-free interest rates.

The current business cycle upswing could not be more different from the former upswing, which commenced in September 1999 and peaked in November 2007. An outstanding feature of the last one was higher productivity growth, which encouraged fixed investment spending.

In contrast, productivity growth has been weak during the current economic upswing, which began in September 2009. Labour productivity, for example, advanced by just 1.2 percent during 2012. Consumption, including spending by government, has been the major contributor to domestic spending and growth and the recovery in investment spending, which collapsed during the recession, has been tepid.

While the upswing has been in place for nearly four years, the ratio of total gross fixed capital formation to GDP (a measure of investment taking place in the economy) remains below the level recorded at the peak of the previous upswing. Not surprisingly, real GDP growth has disappointed.

Ordinarily, a sharp increase in commodity export prices (relative to import prices) raises income growth and domestic savings. However, the increase in South Africa's commodity export prices has been accompanied by higher consumption spending and a decline in the domestic savings ratio. The fall in the savings ratio is reflected in a wider current account deficit, in large part financed by foreign investors purchasing local government bonds.

Government consumption, which in part reflects its wage bill, is at its highest level in history (22.4 percent in 2012), while households have de-leveraged. At 60.9 percent of GDP in the first quarter of 2013, the ratio of household consumption spending remains below 61.7 percent – the level recorded in 2008. But the share of government consumption in GDP had climbed from 18.6 percent of GDP in 2008 to 22.1 percent by the first quarter of 2013.

Government's dissaving is reflected in the significant shortfall on the current account. This twin deficit problem – a combination of a high fiscal deficit and a current account deficit – has left the country vulnerable to any unexpected upward adjustment in global risk-free interest rates.

South Africa's current account balance has been in deficit since the second quarter of 2003. During this period, the country's gross foreign debt ratio has climbed from less than 20 percent of GDP in 2004 to 35.7 percent of GDP (120.1 percent of export earnings) at the end of 2012.

While the overall level of foreign debt, per se, is not high and some 60 percent of the total foreign debt is rand-denominated, it is higher than it has been historically. The increase in the ratio of foreign debt in recent years in large part reflects public sector borrowing. And the persistent upward trend in this ratio is set to continue.

Moreover, in time investors are far more likely to fund productivity-driven investment spending that holds the promise of generating good growth (and returns on investment) in a low-inflation environment. Currently, this is not the case here.

We cannot predict the level of foreign savings inflows into South Africa. But, we do observe that, historically, current account deficits of this magnitude have not been sustained. US Federal Reserve chairman Ben Bernanke's warning in May that the Federal Open Market Committee would need to consider scaling back its purchases of financial assets "within the next few meetings" focused attention on emerging market countries that run large current account deficits and rely on debt capital inflows to fund domestic investment – a group that includes South Africa. As US Treasury yields increased, subsequent to the announcement, the rand and the domestic bond market sold off aggressively.

At least we can argue the currency, at the time of writing, is undervalued.

Given current forecasts, the US policy rate could remain unchanged until 2015. Even so, the US Fed is unlikely to hold off indefinitely. So it is imperative that progress is made in reducing SA's government budget deficit which has been running at about 5 percent of GDP for four years. In the absence of fiscal consolidation, the private sector will need to save more should foreign capital inflows wane.

Less government consumption and higher productivity growth are needed to reduce the vulnerability of the upswing.

*Arthur Kamp is an economist at Sanlam Investment Management*

# China and the coming economic Ice Age?

**INVESTMENT FOCUS**

Uwe Bott

AFTER several years of riding high on foreign investment cash and commodity revenue, emerging markets are in for a shock. The shift is already under way. Net capital inflows in emerging markets stood at $3.9 trillion (R39 trillion at today's exchange rate) between 2009 and 2012. Between 2004 and 2012, net capital flows in emerging markets stood at a staggering $7 trillion, slightly less than half the size of the US economy.

The biggest concern today is that the quality of these investments has deteriorated. After all, the low-hanging fruit of the earlier years is gone, forcing investors to become more adventurous.

The other major development is that China, itself still an emerging economy, has become a major player in investing in emerging markets. It is estimated that as much as 30 percent of capital inflows in these markets in 2012 came from China and if it slowed down its investments now that would be a big blow to these markets.

China's growing role has been based on several strategic calculations. Prominent among them was the need to guarantee that China's appetite for commodities would be met. The best way to secure that is to own a stake in or lend to the commodity-producing companies abroad.

In contrast, US investors invested abroad in search of yield. They were responding to chronically low interest rates and several rounds of quantitative easing that flooded the US economy with liquidity, while domestic investment opportunities have been scarce for years now.

But these incentives may suddenly reverse. Even in a sluggish economic recovery in the US, ultra-loose monetary policy will come to an end.

The so-called tapering by the US Federal Reserve Bank – the ultimate termination of its programme of buying assets, such as mortgage-backed securities – will lead to an increase of market interest rates in the US. That will happen even if the policy rate – the Federal Funds Rate – remains unchanged. This changes the incentive for investors to take home their funds abroad, especially as the risk of their investments there has risen over time.

At the same time, China might not grow at a greater rate than 7 percent per year in the medium term, as it is facing multiple problems. These include challenges to its export-driven growth model, its exponentially greater economic base from which it must grow, sluggish global demand and falling competitiveness with the fastest-ageing population mankind has ever seen.

The common mantra that China must switch from an investment-driven growth model to a consumption-based growth model is easier said than done.

However, this necessary evolution also reduces China's incentive to invest in emerging markets. China will be likely to soon start to deploy more of its financial resources at home.

As if this double blow of slower investments from the US and China were not bad enough, many of the affected emerging markets will also see the price of commodities – their major export products – slump. This is especially true for oil-exporters.

But the good news is that virtually all emerging markets have largely strengthened their international reserves to protect themselves against such shocks.



Yet, important as these buffers are, panicky investors can quickly lead to a rapid depletion of those reserves.

That is a particular danger if such behaviour is preceded or accompanied by capital flight (ie, domestic investors withdrawing their money and taking it abroad).

In looking forward to a world of much slower growth and a significant slowdown of capital flows into emerging markets, it is then important to assess which among them might be most affected. There are three major factors that must be considered. First, how dependent is the country on commodity exports, especially oil? Second, how large a role have capital inflows played in sustaining economic growth in the emerging market economy? And third, how dependent is an emerging market country on such inflows?

The latter two may seem measures of the same thing, but they are not.

A country may have a current account surplus and still benefit from large capital inflows leaving it with a strong balance-of-payments position. By the same token, it may have a very large current account deficit (also referred to as the savings/investment gap) and hence depend on foreign savings, meaning large capital inflows.

In assessing vulnerability to a combined "sudden stop" of capital inflows and a commodity price shock, the list is large for different reasons. Turkey, Romania, Morocco, South Africa and India stand out as being especially vulnerable. They have all run large current account deficits and hence depend on inflows. Brazil and much of Latin America are also at greater risk.

What lies ahead need not be catastrophic, but it will at a minimum require patience and deft policy management.

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