What to do with the windfall gains of African oil exporting countries

Viewpoint
Lamon Rutten

Compared to the previous decade, oil prices have been very high in 2004, and everything indicates they will remain high in the foreseeable future – well above the 20-25 US$ a barrel reference price on which most governments of African oil exporting countries have been basing their budget decisions until recently. Windfall gains for African oil exporters in 2004 were more than US$ 30 billion (compared to 2003 export revenue), and the situation is expected to be even better in 2005. Of this, more than US$ 14 billion accrued to governments, in the form of higher royalties, taxes and direct export revenue for state-owned enterprises. This is a very significant amount: compare it for example with the total amount of foreign direct investment into Africa in 2002 of US$ 11 billion, bilateral grants of around US$ 10 billion, or worldwide World Bank lending for fossil fuel projects that year of some US$ 2.5 billion.

The traditional advice to these governments is that they should save the "surplus" revenue – put it into a stabilization fund which is invested safely in the western capital market, for use in future bad years. For example, in 2004, Managing Director of the IMF Rodrigo de Rato cautioned African countries against squandering the current windfall from oil sales. Mr. Rodrigo de Rato said for countries rich in mineral resources like Nigeria, "a key priority for them is to avoid boom-bust cycles as oil prices rise and fall. This will require that much of the revenue windfall from high prices be saved and incorporated into a medium-term fiscal framework aimed at achieving fiscal and debt sustainability."

I would argue that this is misguided advice. Boom-bust cycles should be avoided, but saving much of the revenue windfall is not a requirement for this. The stabilization fund strategy has by and large failed its promises in the past, and more importantly, Africa has considerable investment needs that can be met by this surplus revenue. The governments of African oil exporters should re-inject at least part of their revenue surplus into strategic investments in Africa's future. Indeed, policy should take the "Dutch disease" risk into account. But why is it that foreign investors would not cause Dutch disease effects, but local investors would? One cannot call at the same time for new investments in Africa, or more aid, and at the same time tell African governments to save oil windfall gains abroad to avoid inflation ! What it really boils down to is trust: can the current generation of Africans be trusted with money, or should it be saved for use by future generations?

One can legitimately argue that in the past, African governments have shown to be very poor at investing oil revenue. Earlier oil booms have resulted in many a white elephant and heavy debt burdens. Exactly for this reason, I would argue for a novel approach: the governments of Africa's oil exporters should put part of their surplus capital (preferably, adding up to several billion US$) into a professionally managed investment fund; non-African oil exporters can be invited to voluntarily contribute to the fund. While governments provide the capital, they would have no influence on investment decisions. There is no lack of African nationals working at high levels in the world's financial market, including in the large western investment banks, and recruiting high-calibre staff to manage such a fund professionally, remote from political interference and according to the highest standards of integrity, will not be difficult.

The investment fund would have the following characteristics:

- Operate like an independent venture capital, mezzanine finance or project finance fund (in effect, the most effective way to move forward would be to have a series of investment funds, including one or more Islamic ones, focussing on different types of risk)
- Under professional management
- Invest wherever in Africa there are viable projects
- Focus on African energy- and transport-related projects
- High-risk, high-reward, long-term perspective
- Go for high leverage and Public-Private Partnerships.
- Give critical feedback to policy makers.

The investment fund would invest in infrastructure and services critical for Africa's growth and competitiveness. This includes the large projects identified in the framework of NEPAD, as well as many smaller projects, for example in transport-related infrastructure, energy distribution networks and trade-related services. In the 1990s, the returns on private investments in Africa were more than 20% (higher than in Asia and Latin America), indicating that there is a large pool of potential projects worth investing in. "Investment opportunities in Africa are reported to offer some of the highest rates of return on investment, even on a risk-adjusted basis." (Arunma Oteh, Treasurer, African Development Bank, at a September 2004 Corporate Council for Africa / US Exim conference)

The ownership of the fund by many of the continent's largest economies will give it an important comparative advantage compared to the (much smaller) western investment funds that now exist, in that political risk factors will play a much reduced role. This will, in effect, allow the fund to leverage its own capital, mitigating the risks in a project and thus attracting supplementary new funds from the western (and Middle Eastern) capital market.

While not all investments will be successful, it can be expected that the returns from this strategy will easily exceed that of putting "surplus" funds on western bank accounts. Why deposit Africa's funds on these bank accounts, from which they are lent to western investors who use them to reap the benefits of Africa's economic potential? And by investing in Africa's economy and trade infrastructure as a whole (rather than just in their own countries), African oil exporters support regional integration in the continent and create new opportunities for their non-oil exporters (in other words, they will promote the diversification of their economies). Importantly, the creation of a fund of this nature will signal to western capital providers that African leaders believe in the future of their continent, and are willing to put their money where their mouth is. The creation of such a fund can considerably boost Africa's growth and competitiveness, even in the short run, making it more likely that the continent can reach the growth rates necessary to meet the Millennium Development Goals. After the high hopes of independence faded away, African leaders have been quite timid. The current oil windfall gives them the opportunity to show that they are ready to take their continent's future in their own hands.

Africa's oil wealth, social justice and development; One of the complex chemical equations that Africans have been trying to balance for a long time without much success. Will they get it right this time?

Oil mining in Southern Sudan (Source: Sudan Tribune)

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