

# **Mitigating the effects of the global financial crisis on Africa**

## **The role of governance and sustainable development**

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*If we are looking for solutions, it appears that sound governance, both of countries and of companies, is an absolute key to the mitigating the negative effects of a global economic crisis.*

It is easy to be gloomy about the effect of the global economic crisis on Africa. However, I was encouraged to see an article in the Financial Times, by Peter Guest(1), which is not the most optimistic journalistic organ of financial matters, with the headline “Africa is a glimmer of hope in the global doom”. The writer pointed out the positive changes in governance and government over the last over the last ten years. The average growth of the continent actually pre-dates the resources boom by several years and has not been entirely resources driven.

There will be a significant difference between countries with good governance and those with less good governance. Countries with better government and governance will do better than those with weak or corrupt government, especially if they use the current crisis to stop and think and build up better relationships with stakeholders and expand the scope of income generation.

Because of my background is in the oil and mining industries, my focus will be on the impact on Resources, particularly because natural resources are extremely important to Africa. Also important is that provision of infrastructures in African countries is vital for economic growth between countries. In the same issue of the Financial Times, it was encouraging to note that in spite of delays, Chevron is progressing the West African gas pipeline. It will take gas from Nigeria to Ghana in the next month or so and will eventually spread it in the rest of Africa.

## **The impact on the Resources Industry**

In spite of glimmers of hope, the impact on African countries is likely to be serious. If we look at the resources industry, in the past four years, very high prices have led to unfounded optimism in the industry. Many people believed that China would not be affected and that there was decoupling of economies. They argued that with China's enormous reserves, the absolute imperative of internal growth in China and the need to maintain growth through internal demand, that the Chinese demand for minerals would continue to be very high. Later, when it seemed that China was on the point of collapse, or at least, economic slow-down, resource prices went down and mining shares reacted likewise, very dramatically and very suddenly. I think both reactions were overdone. We have in fact seen some corrections recently.

The consequences of prices going up and down on resource companies is quite plain to see across the board. Costs are variable for different minerals, it's different for platinum, copper nickel, iron ore and so on, but there are serious problems with some metals. Costs of construction and maintenance in the last four years have been enormously inflated. In some metals almost half the mines in the world are producing at costs above the present price. Because of this, it is likely that some mines will be closed.

Most companies have many projects built into their plans for growth in the last few years to meet booming demand. When demand and prices drop, we see cash flow drop. To fund a similar stream of projects, one needs to borrow money, and because of the credit squeeze, that credit is simply not available. This is not helped by the accelerated depreciation of currency. Projects are no longer funded or at best, are deferred, slowing down the rate of growth.

Some cooling or smoothing of the boom will obviously be beneficial. There are some signs that this is happening, but there are of course significant problems for countries if projects are deferred.

## **What is the impact on African countries?**

If we consider a hypothetical country with sound governance and a very conservative fiscal policy, which has been going along a reasonable growth rate, the immediate impact on commodity prices will clearly erode government revenue. Possible cutbacks in production causes problems of employment and deferment of projects does both – it reduces future employment and future revenue. In many countries we have also seen the accelerated depreciation of a currency, which has a beneficial affect in reducing the dollar cost of mining production in those countries, but clearly has an impact on inflation.

A country with poor government and governance will suffer a great deal more, particularly if, when there were good times, a great deal of money either disappeared or was spent on unwise projects. In these countries, the need is going to be much greater. Projects are most likely to be scrapped or deferred in countries which are less well governed and where there is greater risk of political and social uncertainty. The depreciation of the exchange rate is likely to be much more vicious Because of the

less representative distribution of wealth, with the reduction of income, the possibility of social unrest is much higher in such countries.

In the course of my work, I have lived and worked in over ten countries across the world and visited mining and oil operations in another 35. Over the decades I have observed what the impact of revenue from resources can be and what it can do. I have taken three examples – two good ones and one bad one. In all three cases the extractive industries were run by the same company and the same people were involved.

One therefore comes to the conclusion that a lot has to do with the nature and motivation of government.

### **Learning from the past**

There is a lot to be learnt from the success of other countries. In my early career I worked in Oman. In the 1960s it was a medieval country. There were probably two doctors for a population of a million and a half people. Health care was extremely basic. Infectious disease was endemic. Practices like female genital mutilation were common. It was a very poor country. In the intervening years, as a result of change of government, we've seen the development of a modern country, with a not unreasonable distribution of income, good medical services, good education, quoted by the UNDP as a good example of development. It has a sound government system with a bi-cameral parliament with women in both chambers. It is not a perfect democracy, but a clear move in an enlightened direction.

Likewise, in Malaysia in the sixties, you could tell how people were employed according to race. It was quite clear that the society was divided between Malays, Indians and Chinese. People could guess what people did by simply looking at them. The economy was based on primary products, rubber, tin, oil and gas and so on. Out of that, again through a process of better government, even though Malaysia is politically in some turmoil now, a modern economy has grown. Forty years later, jobs are not racially differentiated. Again, use of revenue in primary products were converted into real economic change and growth. A lot of the support was done through national funds into which people could put savings. The advantage was spread right across the nation. When somebody wanted their money out, they could get it out. The problem with giving people shares is that it is dependent on dividends which may or may not happen. In many ways it's better to try and have a stream of income which goes to local communities. This can be done through taxation.

In Nigeria, where I also worked, the story is plainly less happy. In retrospect, there is a lot to learn from past mistakes. There was military rule, with people who were more interested in their own game than that of the country. In terms of the Shell history this was compounded by a some mistakes that were made. In Nigeria, we naively addressed the visible structures of authority in communities such as the chieftaincy structure or visible local government and assumed that they actually reflected reality. We did not realise that these structures did not necessarily relate to the population as a whole.

## **The importance of culture**

Culture is also important. One of the reasons I continued to work for Shell for nearly 40 years was that the company did have principles. One had a capacity to say, hey, wait a minute, this thing doesn't seem quite right to me. The people didn't say, shut up and get back in your box. They actually asked, 'Well why doesn't it feel quite right?' We could have discussions on a subject. It doesn't mean they got the answer right. One of the problems in the reserves issue was that there was a disagreement between two individuals which resulted in not dealing with the issue. A lack of transparency meant that that issues were not brought to the board – executives tried to solve the issues themselves.

The problem with detecting culturally related risks is that cultural changes happen in subtle ways. Frames of reference shift gradually over time until certain values and behaviour that were thought of as ridiculous, became part of accepted practice. Things which to other people seem crazy, somehow become normal. Take for example, the cosmetic industry. When you think about it, cosmetic surgery was invented to address issues of people who had been badly burnt in WW2. From there it understandably went to repairing the appearance of people who were seriously psychologically affected by how they looked. All very noble. Gradually it then became cosmetic. For example, if I lived in Los Angeles, I would probably have a tuck and nip to my chin. That seems ridiculous, but I believe that if I lived in that society, I would probably go with the flow. My wife has an earring in each ear. I regard that as quite normal for a 60 something year old lady. My daughter, who is 35, has three holes in one ear and I regard that as quite normal for a young woman. But she's going to be 60 one day. When you travel on the underground in London, some people have got rings all over the place. It is perfectly normal to them. For me it looks completely bizarre. Then I ask myself, why don't I regard my wife's two earrings as mildly bizarre?

The danger is that frameworks shift imperceptibly. If you are within the framework it is difficult to detect the framework shifting, so things seem normal. That doesn't help to work out how we prevent it happening, but explains why it happens.

The predominant culture in a country will influence whether companies and countries use their money to invest in the future. It depends very much on the country and their economic philosophy and politics.

A country like Saudi Arabia bases their economy on much lower oil prices. Saudi Arabia maintains as a matter of policy an excess capacity of a million and a half barrels a day, which is very expensive to maintain. It plays a role in balancing oil prices so that we don't have an oil shortage. Clearly OPEC influences the market, but is not a controlling factor. A lot depends on assumptions made in terms of demand for oil, the ability to increase production and the reasons for price rises. It has been fairly obvious for some months that the demand for oil was not going to go up. It's only grown by less than 1% globally for the last four years, even in boom time. You only need a minor slow down for it to reverse. The fact that prices have gone down again is therefore not surprising.. The question is what a country does with the large surpluses generated by possibly temporary high oil prices. A sensible policy is to put some of the surplus into a reserve or investment fund. A country like Kuwait has done this. In other countries you can see conspicuous consumption. Its interesting that Saudi

Arabia is actually putting significant amounts of money into solar research. They are interested in what they do after the oil runs out. As usual, a lot depends on individual leaders and individual wisdom.

There is no doubt that the main issue is the governance of a country, rather than the negative effect of certain international companies, although they play a part in what happens. Twenty years ago, we used to believe that if we ran a reasonable operation, didn't bribe people, and had reasonable community development programmes and good staff development programmes, we were doing what we could and could make a positive impact. But if the government took the money generated and blew it on unwise projects, or stole it, it clearly had unfortunate consequences on the country, but we did not feel that that was something which we as foreign guests could address.. We used to believe that one should not get engaged in the politics of a country in which one worked. My generation was aware of the dangers of international companies interfering and causing 'Banana Republics'. The term, 'Banana Republic' came from the interference of multi-national corporations such as United Fruit in national governments in Central America. We were brought up on, 'Don't bribe people, don't interfere and keep out of politics'.

I don't agree with that position now, but it's not easy to decide what to do. One does not want a world where global companies are actively interfering in the governance of countries. Without controls the outcome would probably be in favour of the global company because it is better organised and because in the end that is human nature. While not absolving the negative effect of some international companies, there are companies that can take some pride and pleasure in contribution of an industry to the positive progress of a country. So what can one do as a company, if one lives and operates somewhere where the government is a mess?

### **Government, business, civil society and labour need to work together.**

There are signs of hope. One is the Global Compact which was launched by Kofi Annan, which invited companies, but not just companies, to subscribe to ten principles of the major United Nation's conventions on human rights; on labour, the environment and development and on corruption. To me the power of this, is not just getting companies to sign up, but the fact that the Compact involves several civil society and labour organisations. If we want to address an issue in a country, it has to be done, not just by the business sector, but by everyone in the country, by civil society and labour working together with government, central and local, to address the issues. One of the strengths of the Global Compact, is its system of Local Networks, which encourages the coming together of these groupings.

If we are going to work together like that, it is essential to build trust. Trust, particularly at the moment, is quite low. If corporations are to work with civil society and labour, we need to be very much more open. This is why I've always been a very strong supporter of initiatives like the Global Reporting Initiative, which allows corporations to use a standard form to report their performance on environmental, social and economic contributions.

In terms of the management of revenue from resources, there has been some very interesting work done by the International Council of Mining and Metals, which is a CEO led organisation of major global mining companies. The work was done in conjunction with development and human rights NGOs. They took case studies of four resource rich countries: Peru, Chile, Ghana and Tanzania and tried to find what factors enhance the health of countries and which do not. They have provided guidelines as to how one can look at the management and distribution of mineral revenues; what's happened to social and economic development in the mining areas; poverty reduction, the important impact of increasing local content and local economic activity by mining projects. It indicates how those projects can integrate with local and regional development planning and very importantly, and I think, coming from the work, among others, of John Ruggie(2), on mechanisms for dispute resolutions. There will always be disputes - even between friends there are sometimes disputes.

It is not possible to completely avoid the negative effects of a global crisis. The world will continue to be cyclical. There will be ups and downs. It appears firmly embedded in human nature that we forget and make the same mistakes again. We need to look separately, in our own countries and globally. There is a tendency of people, particularly in the present situation, to talk about the need for global reform of the financial system to solve the problem and prevent this happening again. There are steps that one needs to take globally. However there is a big danger that everyone looks at the global, and forgets about the local. This can lead to countries dodging the issues and blaming their woes on external events. I've certainly seen that in the U.K. where the government complains that this is fundamentally an imported problem which comes from the United States. They have completely ignored the fact that they were doing exactly the same thing. We had a credit boom, we over extended credit, the government increased its spending beyond the capacity of the economy and now has less flexibility for fixing it than the United States. It is crucial not to instinctively blame the rest of the world for our own problems.

The way any country manages its revenues has to take into account the principles of sustainable development. Revenue needs to be distributed fairly with due regard to the development of communities and the building of infrastructure and capacity.

We know that in certain kinds of mining and other natural resources; the extraction is fundamentally unsustainable. The only justification is that we can use the revenue and the wealth created by that process to convert capital gained from resources into other forms of capital. How that's done and whether it's done effectively, is critical.

### **Companies have a role to play**

We have infrastructures and capacity in local areas, whether they're operating and constructing skills, financial management, health care skills and so on. It is essential that we consider local enterprise development beyond our normal activities. Building relationships and local contracts should be part of our enterprise activity and built into our supply chain. It has to go well beyond the supply chain because when mining or extraction activity stops, where the communities are completely dependent on the mining or extraction activities, the local economy will collapse. In order to prevent

this, it is essential that we work with civil society and other organisations to build capacity in the community. We also need to put mechanisms for conflict resolutions in place.

We should use the present shock to stop and think. If we have to delay a project, it can be a very good opportunity, not simply to walk away and leave it, but to establish a sounder footing and a better relationship in that area.

The delay could be used to establish local government structures to handle income, once it starts coming in again. One of the outcomes of the many studies that have been done, is that if the development of income is in advance of the establishment of local government structures to handle that income, the result is nearly always negative. If you have a wall of money, whether it is from debt forgiveness, aid or resources, if the capacity of the economy to absorb it and to handle those income flows is not there it is usually a disaster. I believe that we can use the delay to help build better structures.

We can also use the delay to build educational capacity, working again with others locally before we start. When a company moves into an area there are enormous expectations of employment. The problem is that in our industries, we need people with a certain level of education and skill sets. Very often, in a community, that level simply doesn't exist. So, if you can invest in advance to help bring up levels of education before construction starts it is highly likely to lead to better outcomes. We could work with civil society and other organisations to prepare for future income.

### **What could governments do?**

In the same way, government might also want to use the downturn to look at what needs to be developed. For example, in South Africa, they could re-evaluate the effectiveness of black economic empowerment. This is an enormously important area. For example, some BEE companies are coming under strain as a result of the downturn. It might be worth looking at what additional government support could be given perhaps in exchange of establishing a broader BEE base. The mining industry and certainly Anglo American, support BEE strongly because it is necessary to do something in the economy to address enormous historical disparities. It is not just a question of ownership equity. Increasing equity will not probably turn out to be a healthy solution. Employment and other forms of equity are much more important. Now could be the time to review and learn the lessons of this initiative – what the outcomes have been, the extent of distribution and what the consequences were. It is also important not to disrupt initiatives which have been agreed in good faith.

It is always useful to reflect whether there is a gap between the dream and reality and then to decide the most effective ways forward. An example of government intervention is where governments in Europe and the United States are encouraging banks and other institutions to move in certain directions.

### **The global system. Balance between regulations and market forces**

There are issues related to global organisations such as the World Trade Organisation

and the United Nations. Regulations have their part to play but we need a combination of a flexible and healthy market and regulatory frameworks. Consciousness about different issues shifts. First there is a primary role of looking at what a particular industry is doing at a particular time. We learn more about the impact of things we didn't worry about before. If you go back to the oil industry in the sixties, we would actually flow our waste into the bush. Now that is absolutely inconceivable. It didn't seem particularly noble at the time but we did it.

The second factor is to take account of the markets and economics and of regulatory frameworks which defend the environment and the interests of society. It is not a question of Markets vs. Regulation It has to be both. You cannot have effective markets without a regulatory framework which describes transparency, quality and competition and so on. There are also certain things which markets without a regulatory framework will not deliver. Consumer markets will not deliver things which are not of immediate benefit to the consumer, but in the long term, may not benefit society as a whole. For example, there is no point in an individual spending 200 or 300 dollars installing an auto catalyst to clean up your exhaust. It's of no immediate benefit to the driver of the vehicle, but it is of benefit to society as a whole, including of course the driver. But without regulation that would not have happened – the market alone would not have delivered it

The balance between regulations and a thriving market is not easy to achieve. The danger of imposing rigid regulations is that they distract people from getting on with the job. Also, in those areas where a global mandate would be useful, there isn't a global policeman.

I am more in favour of developing the voluntary adoption of voluntary global principles and standards which can be applied universally by global companies. Where these have local relevance, over time are accepted as normal practice. The answer is to build standards on the ground, and to use collective pressure to influence investors to invest more responsibly. It's very slow and frustrating and a lot less easy than standing up in New York and calling for mandated standards for everything.

What else could be done globally to mitigate the effects of the global crisis? It would be helpful if multi-lateral institutions could stand by ready to help well governed countries that will be inevitably affected by credit shortages and the resource downturn. Short term budgetary impacts could be mitigated by investing in education and health.

It would also be useful if greater agreement was reached concerning the interpretation of SEC reserve definitions, which are neither clear nor particularly rational. For example, take the example of the Norwegian field Ormen Lange which had five major companies as partners in it. In that field, which involved billions of dollars in investments, all those companies agreed on how much oil and gas was present and could be produced to justify commercially the construction of facilities. They all agreed to within a couple of percent of what that number was. This is the technical reserve figure on which commercial decisions are based. However, the SEC formal hydrocarbon reserves figures for technical reserves varied from about 85% to 25%.of this technical reserve number. We were all looking at the same SEC guidelines and

coming up with completely different numbers. This issue exists in many fields around the world. This is among many things that could improve the situation.

### **Summary and conclusions**

In this paper a number of issues have been explored in relation to how to mitigate the effects of the global economic crisis in Africa and a number of suggestions have been made with respect to the roles of governments and companies. Key to this is the fact that countries are mainly affected by the quality of governments and how a government manages the revenue of their country. Countries that are well governed and are committed to building capacity through education, health structures and more equitable distribution of wealth are more likely to survive than weak and corrupt governments.

We should use the pause to catch our breath. Mitigating the effects of a global downturn will require a great deal of cooperation between government, civil society and companies. Without this, the reaction will be for all parties to take very short term palliative measures including cuts in the wrong areas which will simply result in the same cycle commencing again. Cycles will inevitably return, there is nothing we can do to prevent that. But what we can do is try and make sure that their consequences are not so serious.

Rudyard Kipling wrote a poem called the “The Gods of the Copy Book Headings”. Copy book Headings were those sayings which even in my childhood were still printed in beautiful script at the top of double lined exercise books for children to practice their writing while at the same time hopeful absorbing a few home truths. The ‘Copy Book Headings’ gives us basic and fundamental rules which remind us when we’ve strayed off the path. Kipling said that those Gods of the Copy Book Headings, ‘showed us each in turn,

“That Water would certainly wet us, as Fire would certainly burn:  
But we found them lacking in Uplift, Vision and Breadth of Mind,  
So we left them to teach the Gorillas while we followed the March of  
Mankind.

We moved as the Spirit listed. They never altered their pace,  
Being neither cloud nor wind-borne like the Gods of the Market Place,  
But they always caught up with our progress, and presently word would come  
That a tribe had been wiped off its ice field, or the lights had gone out in  
Rome.’

Although Kipling wrote nearly a 100 years ago, the remarks that he made about the markets were quite perceptive.

“Then the Gods of the Market tumbled, and their smooth-tongued wizards  
withdrew  
And the hearts of the meanest were humbled and began to believe it was true  
That All is not Gold that Glitters, and Two and Two make Four.  
And the Gods of the Copybook Headings limped up to explain it once more.”

## References

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