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**Foreword** by William Lyakurwa, AERC Executive Director

## Managing Commodity Booms in Sub-Saharan Africa

At the eighth African Economic Research Consortium (AERC) senior policy seminar, held in Dakar, Senegal, in March 2006, participants identified the management of commodity booms as a key policy area that needed additional research. Taking this cue from the programme committee, AERC organized its ninth senior policy seminar around the theme, *Managing Commodity Booms in Sub-Saharan Africa (SSA)*.

The ninth senior policy seminar, held in Yaoundé, Cameroon, in March 2007, attracted the participation of 78 policy makers – the largest number ever to assemble for one of these seminars. Cameroon's Prime Minister and personal representative to the Head of State, Ephraim Inoni, gave the keynote address. Senior government officials in attendance included nine ministers and nominees, two governors of central banks, two special advisors, six permanent secretaries, and five parliamentarians – altogether representing 21 countries in the SSA region. The seminar has been described as one of the most successful of such AERC events.

The subject of managing commodity booms is timely because the current booms highlight the need to reconsider Africa's management of commodity booms, which in the past has been inadequate. The danger is that SSA governments often repeat past mistakes by assuming that the booms will be permanent, and therefore make unsustainable long-term spending commitments. In addition, the context for managing the current booms has changed fundamentally because most SSA governments have recently adopted much more participatory economic governance mechanisms. A key challenge for the seminar, therefore, was to examine how the management of commodity booms could be integrated into these participatory mechanisms in order to maximize the transparency of use of resources for growth and poverty reduction. One of the main lessons of the seminar was that each country needed to examine its own policy options, learning from others' experience in the process.

Senior policy seminars are annual forums convened by AERC that provide high level African policy makers the opportunity to come together to learn about the results of AERC research, exchange policy experiences with each other and interact with AERC researchers in an atmosphere of peers, without the pressure of a donor presence. Each seminar features the presentation and discussion of six to ten papers related to a chosen policy theme from which this policy brief is distilled to focus purely on policy makers. This brief, along with the full seminar report and a volume containing the seminar papers, is being published and shared widely with policy makers to inform policy decisions, and within the AERC network to encourage researchers to respond to the key policy issues raised by the participants. The publications will also be available on the AERC website:

[www.aercafrica.org](http://www.aercafrica.org)

## Introduction

Current booms in commodities of importance to African economies bring into sharp focus the importance of managing such booms effectively, so that they are neither panacea nor curse, but major inflows of resources with potential to promote sustainable development and poverty reduction. AERC researchers have recently been investigating how best to manage commodity booms to maximize this contribution to the economy. Discussions by the ninth Senior Policy Seminar were organized around the following seven themes:

- Lessons of international experience
- Africa's management of previous oil booms
- Strategies for managing the current oil boom
- Africa's management of previous solid mineral booms
- Strategies for managing the current solid mineral booms
- Africa's management of previous agricultural commodity booms
- Strategies for managing the current agricultural commodity boom

Welcoming the participants, Cameroon's Minister of State, Augustin Kodock, indicated how timely the subject was for most African governments, and particularly Cameroon. He expressed a wish for strong policy recommendations to come out of the seminar, including strategies to keep Africa's commodity prices at the highest possible levels.

In the official opening address, the Prime Minister of Cameroon, Ephraim Inoni, commended African researchers and policy makers as fully capable of analysing issues, rather than solely relying on lessons from other continents transmitted by international experts. He stressed the importance of the seminar's focus on the impact of commodity booms on government revenues and expenditures. He hoped that the deliberations would improve the future management of resulting budget surpluses and the planning of long-term expenditures to avoid the "boom and bust" cycles of past commodity price volatility. This would help keep Africa on a path of steady development.

## Lessons of International Experience

Governance – especially as it relates to the way public money is spent – is a crucial factor in turning a commodity boom into an opportunity for growth and development in Africa. With regard to non-agricultural booms, three critical public decisions need to be addressed: How much of the revenues should be saved instead of consumed or invested? How much should be invested domestically and how much externally? How should the domestic investment and consumption be divided between public and private sectors? For agricultural booms – given that government should not tax farmers – the main challenges are fiscal, because farmers will initially direct savings into financial assets before investing them.

African policy making has too often been based on lessons and views from other continents.

– Prime Minister of Cameroon

The main lesson of the seminar was that each country needed to examine its own policy options.

Managing booms must be rooted in the participatory planning of government policy.

*Policy recommendations emanating from the deliberations were to:*

- Invest far more domestically in order to increase employment, reduce poverty, change the structure of the economy, and reduce long-term dependence on commodities, external aid and foreign investment.
- Acknowledge that foreign savings and reserve accumulation are politically unpopular and therefore should be used only to smooth short-term consumption.
- Recognize that public and private investments are complements. Public investment should be used to crowd in private investment, for example, by providing export-related infrastructure and pro-agriculture spending (rural roads, irrigation, electrification, extension services).
- Not assume that either transnational oil or mineral corporations, agricultural trading intermediaries, or farmers will save or invest revenues from booms. Therefore, government must tax a proportion of windfalls, especially in order to increase low revenue mobilization rates and fund public investment.
- Use alternative tools such as fiscal responsibility laws, regional economic convergence treaties, and greater scrutiny of budgets by parliaments and civil societies, rather than embarking on the complex process of changing constitutions.

## Management of Oil Booms

The current oil boom is a culmination of traditional causes of supply and demand in many economies, as well as crises in several oil producing countries that affect the supply-side of the commodity. Additionally, there has been a fundamental shift in demand for the commodity in Asian countries. This boom is therefore likely to last longer than the previous ones.

Given that oil is a non-renewable resource, it is vital to reduce corruption, negotiate more beneficial and transparent contracts with oil companies, and ensure that oil companies do not evade taxes. Resources must also be distributed more equitably among the population, taking into account the local socio-political and ethnic context, while revenues should be directed into investments in other sectors to diversify the economy. Checks and balances need to be maximized through parliament.

Full involvement and education of the population and civil society is essential in the management of the resources especially in minority ethnic zones. Civil society can be represented by an independent committee that will advise the government on transparent management. Regional and subregional integration frameworks and peer reviews can be useful, as can support of international organizations. However, government leaders need a clear vision and a workable action plan.

We need to negotiate appropriately with all investors, including the Chinese, and not give our oil away to them.

*Policy recommendations that stemmed from the deliberations included the following:*

- Fundamentally change the management of Africa's oil wealth to enable the continent to achieve sustainable development. SSA countries have performed very poorly in managing the resource allocation and macroeconomic flexibility challenges created by booms, turning oil wealth into a curse. Thus, future strategies must involve a paradigm shift in economic policy, taking account of oil depletion and the management of revenues through an oil fund and the Extractive Industries Transparency Initiative (EITI). Future oil management must be based on deepened reforms, expanded energy access in support of the Millennium Development Goals (MDGs), increased domestic value added, transparency and a long-term vision.
- Because oil appears to be highly correlated with civil strife and conflict, distribute oil revenues more evenly across regions and ethnic groupings within countries to avoid exacerbating tensions and conflicts.
- Apply a three-pronged strategy to manage oil revenues successfully:
  - 1 A macroeconomic framework aimed at ensuring high and prudently invested savings, and an effective counter-cyclical policy to insulate government expenditure from the volatility of oil price cycles.
  - 2 A business plan for stemming real exchange rate appreciations, including measures to enhance the productivity of the non-oil tradeable sectors (especially providing them with contingent credit facilities during the boom).
  - 3 A political and social contract for managing oil revenues, based on democratic participation and transparent economic governance. The success of such governance will depend on political stability, government legitimacy, a long policy horizon, high domestic savings and – in particular – powerful non-oil political constituencies.

The key challenge is for citizens to breathe life into institutions, which are the effective checks and balances on the executive.

While a sound technical economic framework is critical, management of oil rents is profoundly political. The priority is therefore transparent economic governance.

## Managing Solid Mineral Booms in SSA

**P**resentations considered two country cases: Botswana and Zambia. Botswana was cited as an example of a good performer in the management of solid mineral booms. Its high growth has reflected good governance (including democracy, political stability and low corruption), prudent financial management (including cautious planning and forecasting of diamond prices) and macroeconomic stability. Botswana also held successful initial negotiations with its diamond company, resulting in high levels of royalties, and benefited from the controlled and stable nature of the world diamond market. Other measures were to create a Revenue Stabilization Fund, treat the boom as temporary and put in place legally enforceable maximum expenditure limits. The country also invested diamond revenues predominantly into infrastructure, education and health. Nevertheless, the economy has seen little diversification into manufactures, and a high level of unemployment and poverty continues for most of the population, which remains largely rural.

As for Zambia, the country has liberalized its external accounts and introduced a flexible exchange rate regime. More recently, it has pursued prudent fiscal and monetary policies, thereby reducing inflation and the excessive amounts of cash circulating in the economy as a result of the accumulation of foreign exchange reserves. However, Zambia's mines are privately owned and taxed at a fairly low level, and there is no national revenue stabilization fund or international copper market control agreement. Zambia's policy options are thus very limited, largely to market-based hedging instruments to protect its reserves. On the other hand, the country has engaged in an active export diversification policy, which is successfully promoting non-traditional agriculture-related products, partly as a plank of its poverty reduction strategy to improve rural incomes.

Investments in transport and communications and application of new technology to agriculture and forestry are crucial to diversification and higher value-added.

Solid mineral booms provide opportunities for greater economic stability, GDP growth, poverty reduction and development of labour skills. They can also improve the investment climate and facilitate debt repayment. Challenges include renegotiating past agreements with investors during a boom period so as to capture more revenue, adding value through smelting and other procedures, integrating small-scale miners into the boom, and transferring skills more rapidly to locals through training and research. The boom is ideally the period during which a country should introduce new legal frameworks to manage revenues, renegotiate agreements with investors, and set up strong procedures and institutions to improve resource management.

#### *Policy recommendations that stemmed from the deliberations were to:*

- Target resources deliberately to poverty reduction (health, education, social safety nets) and employment creation (incentives to entrepreneurship, micro credit).
- Ensure that foreign investment agreements include clauses to renegotiate royalties when prices rise.
- Institute or enforce checks and balances on the executive, including active parliamentary debate, rather than simply relying on multi-party electoral competition and changes of government.
- Provide more incentive for manufacturing, including export processing zones, as well as for agriculture with tax exemptions for inputs, and support for fertilizer.

### **Managing Agricultural Commodity Booms**

Agriculture remains a crucial sector in most African non-oil economies, especially in terms of employment and earnings for the majority of the population. Kenya's coffee boom in the 1970s, for example, had knock-on boom effects on tea and cocoa prices. This increased revenue, through export, import or consumption taxes, as well as recurrent expenditures. After the boom, however, continued high expenditures and debt accumulation led to high deficits. In other countries high taxes on coffee farmers worsened rural welfare. Lack of diversification or movement up the value chain as a result of the boom – a general problem in SSA – is usually ascribed to poor governance and conflict. The policy solutions to promote diversification are

Africa will need major capacity-building support if it is to capture the gains from current agricultural commodity booms.

improvements to the investment climate, and investments in transport infrastructure and new technologies.

Previously, agricultural booms were limited because Africa was moving from state-controlled to market-based agricultural sectors. Now, however, the top priorities are to ensure that maximum earnings reach producers, to diversify agricultural sectors in order to dampen booms and busts, and to encourage investment by producers and government. Other essentials are providing market information and promoting competition among farmers, and preventing leakage of revenues through smuggling.

Agricultural booms provide enhanced opportunities because they appear medium term. African countries could well benefit due to their renewed commitment to agricultural transformation and to attracting FDI into agriculture. The booms can also present a number of serious challenges. Food security may be threatened by competition between food and export crops and rising food prices. The environment may be negatively affected because of unsustainable production practices.

Steps must be taken to address such threats, as well as to ensure that farmers rather than traders and distributors capture gains and to promote employment generation and poverty reduction.

African governments have limited options for management, and would best focus on national supply management by establishing market-oriented stabilization funds, institutionalizing and strengthening producer organizations, and revisiting commodity boards. As producer countries they need to work together to enhance cooperation, fight anti-competitive behaviour among purchasers, and sign longer-term contracts to stabilize prices. In short, there is need to consider creating an African Commodity Exchange and to add more value to primary commodities.

*Policy recommendations arising from the ensuing discussions were to:*

- Turn general declarations of support for agriculture into detailed commodity-specific strategies with adequate budgets.
- Promote microfinance as one way to assist farmers.
- Strengthen agricultural research institutes for improved technology, research and development, as well as extension services.
- Analyse the potential for intra-African commodity trade, as well as the impact of the Africa-Caribbean-Pacific/European Union (ACP-EU) economic partnership agreements and any potential Doha Round based liberalization.
- Assess the structure of agricultural production more closely – that is, under what circumstances do large farmers, small farmers and agricultural labourers gain?

Countries have different political and economic contexts so options will vary. However, they can choose from among the following:

- Encouraging farmers to diversify into other crops and non-farm activities, and to save and invest their earnings during boom times.
- Promoting national economic diversification into manufacturing, value added and use of by-products by investing boom revenues.
- Establishing stabilization funds and buffer stocks, in addition to investing boom revenues in infrastructure to support farmers – rural roads, electricity, irrigation, extension, technology and research.
- Rethinking and restructuring marketing boards so that they can retain their regulatory role and provide support services to the farmers, plus developing effective systems to improve farmers' access to reliable, accurate and timely market information.
- Encouraging joint ventures between countries for value adding activities, especially within regional trade blocs.

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### AFRICAN ECONOMIC RESEARCH CONSORTIUM (AERC) CONSORTIUM POUR LA RECHERCHE ECONOMIQUE EN AFRIQUE

The African Economic Research Consortium (AERC), established in 1988, is a public not-for-profit organization devoted to advanced policy research and training. The principal objective is to strengthen local capacity for conducting independent, rigorous inquiry into problems pertinent to the management of economies in sub-Saharan Africa. In response to special needs of the region, the AERC Research Programme has adopted a flexible approach to improve the technical skills of local researchers, allow for regional determination of research priorities, strengthen national institutions concerned with economic policy research, and facilitate closer ties between researchers and policy makers. The Training Programme augments the pool of economic researchers in sub-Saharan Africa by supporting graduate studies in economics, as well as improving the capacities of departments of economics in local public universities. AERC is supported by donor governments, private foundations and international organizations. Further information concerning AERC and its programmes can be obtained from:

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