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Item 9 of the provisional agenda*

REPORT OF THE ROUNDTABLE OF GOVERNORS OF AFRICAN CENTRAL BANKS AND SENIOR OFFICIALS OF INTERNATIONAL FINANCE INSTITUTIONS ON THE BALANCE-OF-PAYMENTS AND FOREIGN EXCHANGE PROBLEMS OF AFRICAN COUNTRIES

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Introduction

1. The Roundtable of Governors of African Central Banks and Senior Officials of International Finance Institutions was convened at ECA headquarters, Addis Ababa, from 4 to 7 February 1985.

2. The Roundtable was attended by representatives from the following central banks: Banque centrale des Etats de l'Afrique de l'Ouest (BCEAO), Banque centrale des Etats de l'Afrique du centrale (BCEAC), Botswana, Burundi, Ethiopia. Ghana, Liberia, Malawi, Nigeria, Rwanda, Uganda, United Republic of Tanzania and Zaire.

3. The Roundtable was also attended by representatives of the African Centre for Monetary Studies, the African Development Bank, the Economic Commission for Africa, the International Monetary Fund and the World Bank.

4. The Roundtable elected Mr. Tadesse Gebre-Kidan, Governor, National Bank of Ethiopia, as its Chairman and Mr. Thomas D. Voer Hanson, Governor, National Bank of Liberia and Mr. P. Budeyi, Vice-Governor, Banque de la République du Burundi as first Vice-Chairman and second Vice-Chairman, respectively. Dr. Matthew A. Uduebo, Deputy Director of Research, Central Bank of Nigeria was elected as Rapporteur.

5. The Roundtable was opened by Mr. Adebayo Adedeji, Executive Secretary of the Economic Commission for Africa. In his opening statement, the Executive Secretary gave a detailed account of the dismal performance of the African economy in the first half of the 1980s. He pointed out that for the vast majority of developing African countries the development momentum is being seriously threatened by protectionist measures in the developed countries. The attainment of an adequate level of imports has been gravely eroded by the current recession. Since the early 1970s, the terms of trade have been deteriorating sharply as a combined result of a rise in the import prices of energy, food and capital goods and a persistent weakness in the prices of primary commodities. Added to this are the sharply increasing debt service costs caused by high real interest rates and the appreciation of the dollar. The demand in developed countries for items such as coffee, cocoa, cotton, copper either has stagnated or has been persistently declining. For years the issue of services has vegetated on the periphery of the development agenda and African countries have remained dependent on the developed world for most services and their economies have been sapped by the related financial outflows.

6. The Executive Secretary reminded the participants that the balance-of-payments deficit of developing Africa will not be solved solely by rising levels of external assistance, and that there is urgent need to vigorously pursue regional co-operation and intra-African trade. He reiterated that the balance-of-payments problems of developing African countries is basically a structural one requiring domestically initiated growth and fundamental structural change. There must be a shift of emphasis from the production of a narrow range of primary commodities destined for export and the use of domestic energies to bring about domestic growth.

7. The Executive Secretary then went on to elaborate about the forms, magnitude and sources of foreign exchange leakages in developing Africa. Notwithstanding the relative increase in government's share of export-import trade and the introduction of stringent controls on private business, foreign exchange leakages have continued to grow. Apart from the common means of transferring resources out of a country through overinvoicing of imports and underinvoicing of exports, foreign exchange losses from unrecorded trade, particularly smuggling and the invisible account has been considerable. The value of foreign exchange leakages from the current account alone are estimated at $7 to $9 billion per annum. The Executive Secretary pointed out that the solution to the leakage problem in developing Africa is multi-dimensional and among other steps, would require sound monetary, fiscal, exchange rate and price policies conducive to optimal resource use and allocation. Increased processing of primary export products and streamlining of restrictive exchange control and imports; co-operation in the establishment of common merchant fleets and insurance services and the co-ordination of local consulting services at the subregional and regional levels should be vigorously pursued.

8. The Roundtable adopted the following agenda:

1. Opening of the Roundtable by the Executive Secretary
2. Election of officers
3. Adoption of the agenda and organization of work
4. The balance-of-payments problems of developing African countries - A reassessment:

   (a) Merchandise trade
   (b) Invisibles
   (c) Policies to mitigate the deficit in the balance of payments

5. Foreign exchange leakages:

   (a) Source and magnitude
   (b) Types of leakages
   (c) Policies to prevent foreign exchange leakages

6. Recommendation
7. Adoption of the report
8. Closure of the meeting

Discussion of agenda items

(a) Balance of payments

9. Under this agenda item, the ECA secretariat introduced a study on "The balance-of-payments problems of developing Africa - A reassessment", which was conducted under its programme of work and priorities for 1982 and 1983.

10. The document on balance of payments indicates that in the past decade, shifts of unprecedented magnitude have been recorded in the current account balances of developing African countries. The aggregate current account deficit during the 1970s increased at the alarming average rate of 38.2 per cent per year, reaching a peak of 18,319 million SDRs in 1981. In addition to escalating import growth and a structural concentration of imports on food and fuel for the oil-importing developing African countries, the 1970s saw a general slackening of export growth and adverse terms of trade brought about by rapid increase in the price of manufactures and other basic imports. Even more worrisome is the plight of the least developed and land-locked African countries. A particularly noticeable trend has been the rapid growth of the deficit on the services account which in 1981 was about four times the deficit on the trade account.

11. The balance-of-payments problems of African developing countries became even more compounded in the first half of the 1980s by rising interest rates, fluctuation in exchange rates of the major currencies, especially the appreciation of the dollar, the mounting debt service payments, adverse terms of trade, the protracted recession, protectionist measures particularly quantitative restrictions in the developed countries on the exports of African countries and competition from substitutes.

12. Apart from exacting a great physical toll on human, plant and animal life in a large number of countries, and its negative impact on the balance of payments via reduced availability of exportable commodities, drought also imposed a heavy burden on budgetary resources. Investment in industry, agriculture, infrastructure and social programmes have been trimmed or slashed as funds have to be diverted to meet relief and rehabilitation programmes. In addition, the flow of raw materials for agro-based industries was seriously disrupted.

13. In the discussion that followed the presentation of the studies, the following main issues were raised:

Exports

14. It was argued that undue emphasis was placed on the demand side of the analysis of Africa's export performance and that the statistics produced did not support the basic argument that Africa had followed an export-led development strategy. It was necessary to analyse the supply side of the problem to be able to explain why Africa had lagged behind other developing areas in export performance. It was emphasized that export growth may require developments in the other sectors and that it may be difficult to exploit whatever export possiblities existed if there were no concommitant developments in other sectors such as transportation, marketing, storage, etc.

15. The desirability of ensuring that Africa receives all the foreign exchange accruing to it from exports was stressed. Equally important were the prices paid for Africa's exports. In this connection, it was noted that the prices of most commodities exported by African countries have been declining during the past five years.

16. It was stressed that a large part of the explanation for the poor performance of the export sector was the structure of exports which continue to be dominated by unprocessed primary products and raw materials.

Imports

17. It was noted that the structure of African imports was unduly biased towards consumption. Two items which dominate Africa's import bill were food and petroleum.

18. With regard to reducing food imports, participants addressed the need to revitalize the agricultural sector and to seek means which will lead to the realization of the long-held objective of food self-sufficiency. Further it was stressed that a reversal of the recent change in the food consumption habits in favour of imported staples would contribute towards the improvement of the current account.

19. Reduction in the level of petroleum imports could be achieved through appropriate conservation measures and the development of alternative sources of energy.

20. Other measures for reducing the level and improving the composition of imports were also discussed. In this connection, some participants enumerated their experiences with respect to import controls. The discussion revealed that the result of these import control exercises were mixed.

Invisibles

21. It was noted that the bulk of the current account deficit was explained by payments for invisibles particularly freight, insurance and investment income.

22. These outflows have resulted from the fact that African countries have remained dependent on the industrialized countries for most services. A contributory factor has been the dominance of transnational corporations in African economies.

23. The peculiar problems of the land-locked countries with respect to maritime and inland transport was also discussed.

24. Given the magnitude of the outflows under invisibles it was stressed that unless adequate timely measures were taken to reverse the trend, gains in the other areas of the balance of payments would be largely negated.

Proposals and recommendations on the balance of payments short-term policy and proposals to ease balance-of-payments problems

25. At the national level, it is recognized that African countries have introduced adjustment programmes in their countries some of which have resulted in substantial improvement in the performance of the balance of payments. Under the present circumstances, African countries should continue to make efforts to pursue supply and demand side policies. These may include, *inter alia*, appropriate pricing policies, interest rate policy, credit policies, exchange rate policy and fiscal policy.

26. In the context of developing the agricultural sector, it will be necessary not only to expand domestic food production but also to change the present pattern of African food consumption habits by encouraging Africans to eat more of the food they can cultivate rather than those which must be imported. And within the existing export structure, particular efforts should be devoted to the expansion of the output capacity of some particular commodities that have a potential market.

27. The implementation of import control should be exercised as far as practicable, taking into account its administrative and efficiency aspects, and should be linked to foreign exchange planning.

28. At the subregional and regional level, intensification and strengthening of existing co-operative arrangements should be enhanced. The development of intra-African trade and the simplification of trade operations among African countries is another area of focus. In addition, export diversification should be vigorously pursued.

29. At the international level, bilateral and multilateral donors should be encouraged in their efforts to channel more assistance to finance the agricultural sector and the rehabilitation of the existing social and economic infrastructures.

30. African countries should, through effective negotiations, devise ways and means to minimize protectionist barriers in the industrialized countries. Furthermore, African countries should continue to press for more flexible conditionality and for improving the magnitude of assistance and repurchase period of drawings from the International Monetary Fund.

31. The participants expressed concern at the magnitudes the external debt problem of African countries had assumed and called for innovative measures to deal with this problem. In this respect, the participants also noted that repurchases by African countries on the IMF facilities were assuming significant proportions and called on the Fund to find innovative solutions to deal with this problem.

Medium- and long-term policy and proposals for solving balance-of-payments difficulties

32. At the national level, the thrust of export policy should be to move away from the inherited colonial export profile based on the production of a narrow range of primary commodities and raw materials, whose external demand is falling to a more diversified type of export structure including manufactured goods. Increased processing of primary commodities within the region is another area which deserves serious attention.

33. The composition of imports should be radically altered. Emphasis should be put on the importation of capital goods rather than consumer goods. In addition, efforts should be made to attain food self-sufficiency with a view to reducing the mounting food import bill. As regards energy, conservation measures and production policies, including the development of alternative sources of energy should be vigorously pursued.

34. Industrialization within the region should be stepped up through a more effective use of domestic raw materials.

35. Finally, the expansion of the maritime and the inland transport system with a view to facilitate the movement of goods and services of the land-locked countries should be another point of focus.

36. At the subregional and regional level, the creation of co-operation arrangements without customs and trade barriers, the harmonization of tax systems in order to facilitate industrial co-operation and the local processing of raw materials for marketing within the region should be vigorously pursued. This co-operation may take the form of joint ventures for the establishment of multilateral industries especially in such basic areas as steel, non-ferrous metals and chemicals, the establishment of industrial financing institutions; the shared use of existing training facilities or joint research into new sources of energy should be explored. Furthermore, efforts should be made to co-ordinate the development of joint African services. In particular, common investment should be made in the field of technology, shipping, infrastructure and manpower development.

37. Regional co-operation in production, transport, finance and trade is of paramount importance. It will also be necessary that African countries act together to assist those land-locked countries in the negotiation of freight rates.

38. At the international level, African countries should work together at creating a common base so as to gain more contractual power vis-à-vis the existing foreign cartels and transnational corporations which dominate the invisible trade at the international level.

39. The negotiations to establish mechanisms for stabilizing the prices of primary commodity exports should be expeditiously finalized.

(b) Foreign exchange and financial leakages in Africa

40. A member of the ECA secretariat introduced a paper entitled "Foreign exchange and financial leakages in Africa". This study puts together in suitable framework the various results of the studies carried out on the subject under the auspices of the Economic Commission for Africa.

41. The paper indicates that the issue of foreign exchange and resource leakages has become pervasive and difficult one in Africa owing to the complexities of its forms and sources. Common means of transferring resources. Common means of transferring resources out of a country include the overinvoicing of imports and underinvoicing of exports. Notwithstanding the relative increase in government's share of export-import trade and the introduction of stringent control on private business, foreign exchange leakages have continued to grow. Foreign exchange losses from unrecorded trade, particularly smuggling, are believed to be considerable.

42. Tentative estimates by the ECA secretariat for 1979 reveal that foreign exchange leakage from the commodity account of the balance of payments alone aggregate $4.5 to $6.5 billion from the African region. This is a considerable sum of money amounting to between 4 to 5 per cent of the value of total merchandise trade, that is import and exports together.

43. Unlike visible trade, invisible exports have no fixed point of exit. And because of the heterogenity of invisible operations and the narrowness of the data base, it is difficult to estimate resource leakages associated with the invisible trade account. However, preliminary estimates show that close to $0.5 billion in freight charges leak out of the African region each year. Even in the few cases where some attempt is made to "indigenize" the insurance business, heavy dependence on foreign reinsurance remains. It is estimated that close to $100 million worth of foreign exchange drain out of the region annually. Given the estimated annual total of about $2 billion in African insurance payments, leakages come to around 5 per cent of the value of service. Other significant areas of foreign exchange leakages in the visible trade account include tourism and travel abroad. The "unjustified" components constituting leakages from these sources are estimated at about $1.3 billion per annum for the African region. Another source of foreign exchange leakage is inappropriate technology.

44. In summary, the value of foreign exchange leakages from current account (of the balance of payments) alone are estimated at $7 to $9 billion per annum and accounted for 4 to 6 per cent of total current account.

45. In the discussion that followed the presentation of the study, the main issues which emerged were definition, leakages on trade account, on invisible account and other types of leakages

46. It was pointed out that a clear working definition of leakages was necessary. There were some problems with the definition of leakages which did not seem to take into account the gains occurring from trade or the problem of the distribution of these gains. It was remarked, for example, that expenditure on education abroad

was not a leakage, since it was payment for a real service rendered not available domestically but represented an investment in the future. Questions were also raised on the basis of the quantitative estimates presented.

47. On leakages occurring on the trade account, the discussion centred on the experience of countries with pre-shipment and other foreign trade control measures. These countries were generally satisfied with the practice which had brought important savings though there were difficulties with shipment fraud and collusion between importers and agents. Some countries also described their experience with exchange controls. It was suggested that selectivity could be used in import controls at the post-shipment stage, but this raised some problems as to the appropriate sampling procedure. Experiences with export controls were also discussed but it was pointed out that too many controls may deter exports.

48. On the invisibles account the discussion focused on leakages occurring from services payments, capital flight and insurance. The experience of some countries in establishing national insurance companies was discussed. An account was also given of the problem raised by the transfer and repatriation of bank notes and in general by capital flight, which in some cases are due to interest rate differentials.

49. Other types of leakages considered were those of migrant workers, brain drain, inappropriate technology, and overpricing of consultancy and technical services. It was underlined during the discussion that there were policy-induced leakages arising mainly for example from inappropriate policies which provided a strong incentive for transferring resources.

Short-run policy proposals to reduce foreign exchange leakages

50. As the bulk of leakages arise from goods and services flows, it is in that area that policy measures should be concentrated.

51. At the national level, given the fact that overinvoicing of imports and the underinvoicing of exports play a prominent role in foreign exchange leakages, measures to reduce them should include rationalization of foreign exchange control and pre- and post-shipment inspection to ensure proper invoicing both in terms of prices and quality.

52. Other aspects for the better control of foreign trade flows include, among others, the proper licensing of corporations and individuals engaged in foreign trade, the promotion of the participation of nationals in foreign trade through indigenization measures and quantitative and other controls of trade which would limit the importation or exportation of undesirable commodities. Traditional controls like tender boards, customs management and organizational improvements in the customs and trade services will ameliorate resource leakages problems.

53. As controls involve costs, proper consideration should be given to evaluate the net gain from tighter controls, since these can considerably hamper the movement of goods and services. A proper balance should therefore be struck between leakages control and the promotion of trade.

54. Leakages in the invisible accounts are also sizeable and occur in tourism, freight and insurance services, and capital movements. Some countries have in this respect established national insurance companies to reduce payments to outside insurers. However, the need for international insurance has not been eliminated. National shipping lines and/or national airlines may also contribute to the reduction of leakages, but experience has shown that African countries are not in position to act in isolation in this field and that the costs incurred may far exceed gains; co-operation among African countries appear to be the best way of providing viable and competitive transport services.

55. <u>At the subregional and regional level</u>. Cross-border trade is estimated to be quite important in Africa. While part of this trade ends up outside Africa, the best policy alternative appears to be in removing as much as possible intra-African flows from the sphere of smuggling and other illegal activities. Greater intra-African economic co-operation will contribute to solve the problem by eliminating obstacles to the free movement of trade between African countries through the creation of customs unions, common markets, and other co-operative arrangements like preferential trade agreements. Monetary arrangements will also play a crucial role, since the lack of convertibility of most African currencies is a major impediment to intra-African trade.

<u>Medium- and long-term policies</u>

56. Leakages arise from a variety of reasons, associated largely with the fraudulent behaviour of private interests, but also partly with government policies. Action to eliminate them should therefore focus on policy improvements and improvements in administrative controls.

57. <u>At the national level</u>. Policies should be adjusted to discourage economic agents from fraudulently transferring capital abroad. Streamlining measures in the planning system and particularly in the management of parastatals and other government organizations are necessary. Measures to strengthen management and accountability should be intensified. The problem of corruption, indiscipline and inefficiency among public servants has also to be addressed, as it constitutes an important determinant of resource losses in the countries of the region.

58. <u>At the subregional and regional level</u>. Progress towards greater integration of the economies will contribute considerably to reducing leakages, since such integration will generate considerable gains from mutual trade and specialization.

59. <u>Debt relief</u>. The repayment of debts has become problematic, even for IMF stand-by and other credits. The high level of interest rates is a major factor of the debt repayment difficulties which result in a large outflow of resources from the region at a time when additional resources are acutely needed. International

co-operative action should therefore be taken to lessen the debt burden on the lines of the agreements arrived at with Latin American countries which have included limits to interest rates, the provision of new resources to smoothen the debt repayment process, etc.

60. The participants expressed appreciation to the ECA secretariat for the two studies which were used as background material for their discussion and which facilitated their deliberations. They however, advised that due consideration be given to their comments on the studies particularly with respect to updating of the statistics, ensuring the accuracy of some of the statements and the inclusion of a discussion of the capital accounts before publication.

61. The participants at the Roundtable expressed their gratitude to ECA for providing high-quality documentation for the discussion and for providing efficient services throughout the duration of the meeting. Participants also expressed their thanks to the Government and people of Socialist Ethiopia for the warm African hospitality accorded them during their stay in Addis Ababa.

62. Adoption of the report and closing. This report was unanimously adopted on Thursday, 7 February 1985. In his closing remarks, the Chairman thanked participants for their contribution to the successful completion of their deliberations and wished them a safe return to their respective countries.