Fake It till You Make It Nations and Bling Bling Economics: Debt, Dictatorship and Underdevelopment

Not too long ago, Angola opened an embassy in Nairobi on a quite well-appointed address on Redhill Road in the diplomatic suburb of Gigiri, a road I use frequently. You couldn't miss it. It had an outlandish gate and a black granite signboard with gold lettering. I was rather intrigued that Angola would need such a large embassy in Kenya. I have made a point of observing how much activity was going on there– very little. I passed there the other day and lo and behold, the outlandish gold lettered black granite signboard was gone, replaced by a more modest one announcing the Botswana High Commission. The Angolan foray would have cost no less than $10 million, and I would imagine that Kenya was not the only country that Angola had spread its diplomatic footprint. What has changed?

Angola has squandered the oil bonanza of the last decade. Angola is Africa's second-biggest oil producer after Nigeria, with a daily output of 1.6 million barrels of crude and 18 million cubic metres of natural gas. There is an economic principle that windfall earnings should be saved. Angola did not save. Instead, it leveraged the oil boom to pile up debt. Angola is China's biggest debtor in Africa, owing US$ 23 billion accounting for about a fifth of Africa's debt to China.

If Angola had set a windfall benchmark at $50 per barrel, its nest egg for the five and a half year oil boom (April 2009 to May 2014) would have been in the order of $100 billion on crude oil alone ie. excluding natural gas. A conservative investment yielding 5 percent a year would be earning Angola

$5 billion a year to invest in infrastructure or whatever else it chooses. This is how Norway got rich on oil. Norway's sovereign wealth fund, the worlds largest, is now worth a trillion dollars. If Norway was to pay dividends from the fund to its 5.2 million citizens, each would get US$9,000 a year.

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They say once bitten twice shy. Not Zambia. When I was a college student eons ago, Zambia was a case study on how not to manage an economy. Zambia rode the post independence commodity boom into middle income status by the early seventies. At $600, Zambia's income per person was one-third higher than the Sub-sahara Africa average. In Nairobi, Zambia's heydays are represented by its well-appointed embassy property on Nyerere Road, overlooking Uhuru Park. When commodity prices receded from the late seventies, Zambia plugged its finances by borrowing – and borrowed itself into poverty. Over the next decade, Zambia's foreign debt increased seven-fold, from one to seven billion dollars. By the mid-90s when it got HIPC (Highly Indebted Poor Countries) debt relief, average income adjusted for inflation was half of the mid-1970s level.

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Copper prices surged again in the 2000s peaking in 2011 at $4.60 a pound, about the same in inflation-adjusted terms, as at the 1970s peak. In 2012, against the backdrop of retreating copper prices, Zambia debuted in the Eurobond market, borrowing $750 million. It also borrowed heavily from China. Copper prices have fallen again and Zambia is in debt distress. The eurobonds are now trading at around15 percent yield, almost three times the debut bonds 5.6 percent yield at issue. What this means is that the bonds for which investors paid $94 are now trading at $34. It means that Zambia is now effectively locked out of any more borrowing in the sovereign bond market. Will Zambia turn around its finances before the bonds are due for re-financing? Doubtful.

Zambia is only slightly less dependent on copper now than it was in the 1970s. Copper still accounts for two-thirds of exports. Zambia has no shortage of low-hanging fruit in terms of diversification options: it has plenty of idle arable land and underexploited tourism potential. Chile was once as copper dependent as Zambia. In fact, copper still accounts for half of Chile’s exports. But Chile has diversified its economy and worked its way up to being the first Latin American country to be admitted to the OECD club of rich countries. Interestingly, Chile has become a wealthy country without following the Asian Tiger holy grail of export manufacturing, but rather by diversifying to services and agricultural exports. Its other key exports are agricultural including horticulture, wine and fish, especially farmed salmon.

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Historically, financial recklessness on this scale was the preserve of resource-rich African countries. But the disease has spread all over the continent. Resource-poor countries such as Ethiopia and Kenya are now just as reckless as the resource-cursed. In the past, resource-poor countries simply did not have access to the money to steal or finance megalomania. When they tried to do so by domestic borrowing and printing money, the macroeconomic feedback loop quickly kicked in and wreaked financial havoc. Moi learned this lesson. Mugabe did not. He ended up with a hyperinflation for the ages, and the demise of the Zimbabwe dollar.

There are two reasons why resource-poor countries have also caught the disease*:* the 2008 global financial crisis, and China.

Since the global financial crisis, which began in 2007 and properly set in the next year, the financial markets have been awash with money churned out by the US Federal Reserve and other central banks, thereby depressing interest rates to near zero, prompting money managers to go looking for better returns in emerging markets in what is known in market lingo as “hunting for yield”. Aggressive salesmen were everywhere scouting for and massaging the egos of potential borrowers. When Kenya set out to debut in the Eurobond market it indicated that it would raise a $500m “benchmarking” bond whose proceeds were to retire a syndicated bank loan borrowed two years before, and which was the only foreign loan in Kenya’s books at the time. By the time the issue was going to the market, it had grown fourfold to $2 billion. By the time it closed, the government had borrowed $2.8 billion.

Within weeks of the successful debut, the treasury mandarins were talking of Sukuks (Islamic bonds) and Samurais (Japanese Yen denominated bonds), like children accidentally locked inside an ice cream parlour. Other than the syndicated loan repayment of $600 million there is no trace of anything financed with the money.

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China is getting more than its fair share of flak for Africa's debt distress. The fear of the Dragon is over the top. Unlike the Western banks and markets which are embedded in the Western power structure, China will have little recourse when countries default. It cannot run them through the mill we saw "the troika" run Greece when it went into debt-distress in 2009. The head of China Export and Credit Insurance Corporation, known as *Sinosure* was recently quoted lamenting the poor quality of China's infrastructure loans abroad. He went on to disclose that the agency is already a billion dollars out of pocket on Ethiopia's new railway, whose preparation he termed "downright inadequate". "Ethiopia's planning capabilities are lacking, but even with the help of *Sinosure* and the lending Chinese bank it was still insufficient."

It has also been reported that China may offload its infrastructure loans to the secondary market. The plan is to sell the loans to the Hong Kong Mortgage Corporation which will in turn repackage them, dice them up and sell them to investors, thereby releasing liquidity back to the primary lenders such as China Exim Bank to make more loans. This is not funny. First, the lenders admit that they have made dud loans. Then they follow this with an announcement that they will sell the same to investors. It is a scheme such as this, which mixed up low risk and high risk (a.k.a sub-prime) mortgage loans into securities known as Collateralized Debt Obligations (CDOs) that precipitated the erstwhile mentioned global financial crisis. More poignantly, the Dragons debt trap diplomacy as it’s been called, begins to look uncannily like hunting for yield.

That is the supply side. On the demand side, you have African leaders who have no ideas of their own. From import substitution industrialization, to neoliberal orthodoxy in the 80s, to poverty reduction strategies and now infrastructure-led growth, they wander thoughtlessly from one aid paradigm to the next, all the while living up to Fanon’s prediction that they were destined to become “a transmission line between the nation and capitalism.”

The bigger problem is delusions of grandeur. Seemingly every one of these African big men has a Lee Kwan Yew complex. Even Uhuru Kenyatta, a man who couldn’t run an orderly kindergarten in a children’s park if his life depended on it, is prone to bouts of megalomania during which he comically dons military fatigues and goes around doing General Park Chung-hee skits.

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Africa has its economically successful nations: Botswana, Namibia, Mauritius, Cape Verde and the Seychelles. What do these successful African nations have in common? First, they are all small. Three of them are small island nations. Namibia is large geographically, but its population is only 2.5 million people. Second, they are also successful democracies. The five are consistently the highest ranked African countries in democracy league tables such as the Economist’s Democracy Index and the Freedom House Index.

Why are Africa’s small countries more politically and economically successful than the big ones?

Size matters. It is easier to build a small nation than a big one. Small islands are natural nations, hence it should not surprise that all the small island nations are successful. Madagascar is Africa’s sole big island nation, and it is not successful at all.

The big African countries are almost invariably very ethnically diverse. Recently, someone on social media asked me why benevolent dictatorship cannot work in Africa the way it worked in South Korea. My answer was a question: what tribe will the dictator be? He has not responded. Proponents of developmental autocracies fail to recognize that the East Asian countries are old nations, not the arbitrary colonial creations that African countries are. Korea is a culturally homogenous society with unified dynastic rule going back to 900 AD, and a political history, known as the Three Kingdoms, going back another millennium. The Thai Kingdom dates back 700 years.

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Ethiopia is Africa’s oldest nation-state, and the only one that is not a colonial creation. It is also one of the largest and most diverse(100 million people, over 80 officially recognized ethnic groups). After the Derg’s reign of terror, Ethiopians adopted a constitution based on a loose ethnic federation. But Meles Zenawi could not resist the allure of the developmental autocrat. He borrowed and built like a man possessed but the economic miracle did not materialize, and Ethiopians, tired of autocracy without prosperity, took to the streets. The edifice has unravelled. The leadership is coming to terms with a historical fact that the rest will be reckoning with sooner or later: political development precedes prosperity.