CONCEPT NOTE

Financing Natural Capital: Policies for Value Chain Development in Natural Resources in Post COVID-19 Africa

A Brainstorming E-Policy Seminar

Hosted by African Development Institute (ADI), African Development Bank Group under the auspices of the Global Community of Practice on COVID-19 Response Strategies in Africa (G-CoP).

12 October 2020, Time 14:00 – 17:00 hours (Abidjan time) Western Hemisphere
13 October 2020, Time 08:30 – 11:30 hours (Abidjan time) Eastern Hemisphere

I. CONTEXT

The COVID-19 pandemic continues to significantly impact economies and livelihoods globally. Several measures countries are taking include containment policies to slow down the spread of the virus such as lock-down of economies, border closures, social distancing, and significant easing of monetary and fiscal policy stance as well as significant investments in drug and vaccine discovery. Countries have doled out trillions of US Dollars in fiscal stimulus to help families and business to mitigate the impacts of the virus on livelihoods.

In Africa, while the number of active cases in many countries are much lower than in other countries such as the United States of America, Brazil, India and Russia; the impacts of COVID-19 on the economy is predicted to be severe. The African Development Bank Group’s African Economic Outlook (AEO) 2020 Supplement estimates that “Africa could suffer GDP losses in 2020 between $145.5 billion (baseline) and $189.7 billion (worst case), from the pre-COVID–19 estimated GDP of $2.59 trillion for 2020. Some losses are carried over to 2021, as the projected recovery would be partial. For 2021, the projected GDP losses could be from $27.6 billion (baseline) up to $47 billion (worst case) from the potential GDP of $2.76 trillion without the pandemic. The most affected economies are those with poor healthcare systems, those that rely heavily on tourism, international trade, and commodity exports, and those with high debt burdens and high dependence on volatile international financial flows. The overall impact of the pandemic on socioeconomic outcomes remains uncertain, however. It will depend crucially on the unfolding epidemiology of the virus, the extent of its impacts on demand and supply, the effectiveness of public policy responses, and the persistence of behavioral changes”

Some countries have seen a sudden uptick in inflation of up to 5%, and expansionary fiscal spending could double by the end of 2020. Remittances and foreign direct investment could plunge significantly. Between 28.2 and 49.2 million more Africans could be pushed into extreme poverty and an estimated 25 - 30 million jobs could be lost by the end of 2020.

One of the channels through which the virus is impacting on most Africa countries is precipitous fall in the prices of crude oil, some minerals and other natural resources (hereinafter referred to as natural capital). Natural capital which refers to the stock of all the resources that are easily recognized and measurable, like minerals, energy, timber, agricultural land, fisheries and water.
Natural Capital is the basis for economic growth in most African counties. However, the inherent resilience of a mature beneficiation system (upstream and downstream) is absent for most natural resources use on the continent. Natural Capital is also the source of all ecosystem services such as air and water filtration, flood protection, carbon storage, pollination of crops, and habitats for wildlife, which are fundamental for economic and human wellbeing. With its rich endowment in natural capital (arable land, crude oil, natural gas, diamonds, gold, nickel, uranium, pozzolana, fisheries, timber, titanium, graphite, iron ore, phosphates, aluminium, copper, cocoa, tea, coffee etc.), natural capital is the foundation for economic production and consumption in Africa, and indeed globally.

However, natural capital is often not considered in national accounting. Thus, they are neither captured in the financial calculation of the wealth of countries nor are they explicitly considered as assets in national planning and/or risk ratings of countries. This omission not only leads to under-prioritization of natural capital and its unfettered exploitation, it also precludes strategic investments in the use of natural capital as a key strategic asset class, which is the basis for most economic production in countries, in development finance and policy.

Africa hosts 30% of the world’s mineral reserves and accounts for more than 20 percent of global annual production of five key minerals namely; 80 percent platinum, 77 percent cobalt, 51 percent manganese, 46 percent of diamonds, 39 percent chromium and 22 percent of gold. Africa also possesses 60 percent of world’s arable land, 13 percent of the global population and is the most youthful continent with about 60 percent of its population under the age of 25 as well as abundant energy potentials. Despite this wealth in natural capital endowments, African economies remain among the least developed countries in the world with the size of economies amongst the lowest compared to other regions.

The reason for this is not far-fetched. As the President of the African Development Bank Group, Dr. Akinwumi Adesina always say, “No one eats potential. No one drinks oil or smokes gas”. Until natural capital is turned into productive economic assets, they cannot be counted in the Gross Domestic Product (GDP) of countries. To turn these potentials into wealth, Africa must turn its natural capital endowments into economic wealth in a sustainable way. This emphasizes the importance of value addition to the natural capital endowments of the continent.

Value addition to Africa’s natural capital is usually minimal. For instance, while the region participates in global value chains (GVCs) development and integration, it is mostly through upstream production which embodies production of raw materials that go on to service value chains in the importing countries. This is a trend observed mostly in the natural capital (agriculture produce e.g. cocoa, crude oil and mining) found in Africa where most of them are exported without much value addition. Only a few countries on the continent seem to have managed to develop and harness their local value chains in natural capital and report at least 50 percent involvement in GVCs. This trend continues to undermine efforts towards inclusive and sustainable development as much of the processing is done in the importing countries whose citizens benefit from employment created in the refining sector. Value chains are crucial as they can bring about new forms of production, technological transfer and development, logistical development, labour skills upgrade, long-term industrial upgrade, job creation, poverty reduction, inclusive growth and global networking. COVID-19 has highlighted the need for countries and regions to build value chains at national, regional and continental levels to reduce vulnerabilities to exogenous shocks such as fluctuations in global market prices and/or health pandemics.
As countries explore policies to rebuild their economies, it is important that they are provided policy options to build back better economies that are more inclusive, efficient and resilient – hence better able to meet the needs of citizens today and tomorrow despite future headwinds and shocks such as COVID-19. COVID-19 is a pandemic among pandemics in Africa. It is not the first; and will most likely not be the last. However, considering its transnational nature, it is a crisis that presents some opportunities that Africa should not waste. This is particularly the case for countries whose economies are heavily dependent on exporting natural capital.

Considering Africa’s rich endowment in natural capital, investing in natural capital (natural capital accounting, value addition and value-chain development) is a smart strategy for building back better economies in Africa, post-COVID-19. There is an urgent need to provide countries with evidence-based policy guidance on how the continent could harness its natural capital to ‘build back better’. It is also imperative in such discussions to include serious consideration of the role of women in mining (and other natural resource categories), the role of small-scale and artisanal production and the opportunities for new levels of transparency via various distributed digital architectures.

The ADI in collaboration with the African Natural Resources Centre (ECNR) of the African Development Bank will be hosting a global community of practice – G-CoP seminar on: “Financing Natural Capital: Policies for Value Chain Development in Natural Resources in Post Covid-19 Africa”. The e-seminar will be hosted on 12 October 2020, Time 14:00 – 17:00 hours (Abidjan time) for delegates from the Western Hemisphere; and 13 October 2020, Time 08:30 – 11:30 hours (Abidjan time) for delegates from the Eastern Hemisphere, respectively.

ADI plans to host the seminar in partnership with the United Nations Environment Programme (UNEP), African Union (AU), United Nations Economic Commission for Africa (UNECA), World Wide Fund for nature (WWF), the Green Growth Knowledge Platform (GGKP), the United Nations Statistics Division (UNSD), the World Bank’s Global Program on Sustainability (GPS), the Green Growth Institute (GGI), the International Resources Panel (IRP), World Resources Institute (WRI), UN-INRA, the Australia-Africa Research Group of Murdoch University, Western Australia, and the Environment for Development (EfD) Network – Gothenburg University, Sweden.

II. RATIONALE FOR THE SEMINAR

The COVID-19 pandemic has not only exposed the inequities in the current health, social and economic governance systems, it has also shown the need for countries to harness their own resources sustainably in order to be able to provide for their citizens in times of need as we are now and in the future. Mapping and assessing the value of natural capital in Africa; de-risking public and private sector investments in the sector; and integrating natural capital as an asset in economic policy making and planning in Africa is therefore critical now more than ever before. Africa needs to harness its natural resource potential to be able to accelerate inclusive and sustainable development on the continent.

Existing evidence show that over the long term, on average, the real prices of most primary commodities produced by African countries (except copper and gold) have trended gently down.
and exports of these products have declined over time thus impacting export revenues (Figure 1). The benefits of technical progress and value addition to these commodities do not therefore accrue to the respective economies.

Figure 1: Real Prices of Cocoa, Coffee, Cotton, and Tea (1960 – 2020)\textsuperscript{1}

Economic growth in many African economies continue to rely on primary commodity price movements due to lack of capacity for value addition to export commodities and institutional capacity to diversify economies. This has implications for export revenue mobilization, fiscal sustainability, debt vulnerability, and capacity to implement expansionary fiscal policy at the scale required to provide adequate support to citizens in times of exogenous shocks, including during disease pandemics such as COVID-19.

Despite the proven natural capital potentials of Africa, especially in agriculture\textsuperscript{vii}, energy\textsuperscript{viii}, mining and other extractives, African countries continue to export primary commodities\textsuperscript{ix}. With a few exceptions, the degree of processing (value addition) in Africa’s commodity exports remains generally low and the share of local labor in their value is relatively small. For example, Africa accounts for 70 percent world production of cocoa beans (Figure 2).

Figure 2: Cocoa Production in the World, 1961 - 2017\textsuperscript{2}

\textsuperscript{1} Data Source: https://datacatalog.worldbank.org (Pink Sheet Accessed on:14-05-2020)
\textsuperscript{2} Data source: FAOSTAT 2020
However, about 80 percent of Africa’s cocoa production is already sold even before it is harvested\textsuperscript{d}. Africa accounts for about 21 percent of world’s cocoa grinding\textsuperscript{i}, and at most 1 percent of the global chocolate market. Raw cocoa exportation is tantamount to exporting jobs from Africa. In 2011 the chocolate industry employed about 70,000 people in the European Union and United States\textsuperscript{xii}. The chocolate industry retail market in 2017 was valued at US$ 106.19 billion with 43 percent utilization of all cocoa produced. In 2026 its retail market value is expected to rise to US$ 189.89 billion. Yet, Africa only earns 3 – 6 percent of the chocolate industry’s retail market value even though it is the main producer of cocoa.

Just like cocoa, the story of crude oil production in Africa is similar. Africa’s contribution currently translates into about 9 percent of global output of crude oil. However, about 75 percent of African produced crude oil is exported in raw form\textsuperscript{xiii}. Nevertheless, Africa remains a net importer of refined petroleum products. Some of Africa’s large economies rely on crude oil exports revenues for up to 50 - 80 percent of overall government revenues. These countries, in turn, spend a substantial percentage of the foreign exchange earnings from exporting crude oil on importing refined petroleum products and subsidizing the product to enhance affordability to citizens. By focusing on upstream investments in oil and gas exploration and exporting crude oil, these economies invariably export jobs and revenues that come for the midstream activities (processing and transportation) and downstream activities (refining, distributing, marketing, and selling oil and gas products), respectively\textsuperscript{xiv}. The sharp decline in the oil prices during the COVID-19 lockdown have shown, once again, the risks associated with over reliance on export of crude oil for national incomes. While the health impacts of COVID-19 in most African countries have been limited, the economic impacts are predicted to be severe due to the exogenous shocks associated with decline in aggregate demand in the oil importing countries.

Similarly, for mineral resources the largest exporters of raw copper for example are African with Zambia and South Africa exporting 43.7 percent and 12.8 percent of total global experts in 2018 (Figure 3).

Figure 3: Raw Copper Export (Percentage of Total Global Exports, 2018\textsuperscript{3}.

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\caption{Raw Copper Export (Percentage of Total Global Exports, 2018\textsuperscript{3}).}
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Of the Zambia’s exports, 46.2 percent are imported by Switzerland, 17.4 percent by China, 16.8 percent by South Africa, 6.99 percent by Singapore, 4.2 percent by India and 2.02 percent by Japan. The total global trade in raw copper was worth US$12.4 billion in 2018, out of which US $5.42 billion went to Zambia), US$ $1.59 to South Africa and US$ $307 million to Democratic Republic of the Congo, respectively. In the same year, the top importers of raw copper were China (US$3.82 billion), Switzerland (US$2.52 billion), Belgium-Luxembourg (US$1.76 billion), South Africa (US$910 million), and Germany (US$727 million). A market concentration analyses show that Zambia’s share of the global export of raw copper has grown significantly since 2008.

Between 2017 and 2018 the exports of Copper Ore grew by 9.76%, from US$58.5 billion to US$64.2 billion. In 2018 the top exporters of Copper Ore were Chile (US $18.6 billion accounting for 29.1 percent of the global exports), Peru (US$13 billion, account for 20.3 percent of the global exports), Australia (US$4.56 billion accounting for 7.1 percent of the global exports), Indonesia (US$4.24 billion, accounting for 7.1 percent of the global exports), and Canada (US$2.8 billion accounting for 4.36 percent of the global exports). Only DRC exported copper ore in 2018. Again, the top importers of Copper Ore in 2018 were China (US$31.7 billion accounting for 49.4 percent of global imports), Japan (US$9.19 billion accounting for 14.3 percent of global imports), South Korea (US$4.26 billion accounting for 6.64 percent of global imports), Bulgaria (US$2.82 billion accounting for 4.4 percent of global imports), and India (US$2.71 billion accounting for 4.34 percent of global imports), respectively. Market concentration analyses show that Chile, Peru and Indonesia dominate the iron ore export trade since 2008. The same pattern is observed when we examined trade in copper ore and concentrates.

Just using the case of training raw copper and copper ore, the difference is clear. The raw coper market which Africa dominates was worth US$12.4 billion while trade in copper ore where African countries have a very low share was worth US$64.2 billion in the same year. The market size for raw copper and copper ore are estimated be worth about US$12 billion and US$69.5 billion by 2021, respectively. As in most commodities, the market value of processed commodities is mostly on an upward trajectory while those of raw commodities are on the reverse, tending gently down over time.

In addition, with the rapid evolution of the fourth industrial revolution technologies, it is expected that the value of copper products that is beneficiated from raw copper will have huge markets in the new digital economy – which has been fast tracked by COVID-19. The demand for copper wire for solar panels and micro-grids, direct current (DC) motors will only be on the rise as aggregate demand for cleaner technologies grow. Copper wires will be required for the mass production of the e-bikes and e-cars, robotics, e-offices powered by digital technologies of the future. Will Africa continue to export raw copper (play in the low value market) and import copper ore and the processes copper produces for the new digital economy? The brief case study of copper presented above suggest that this is not the strategy for the Africa we want, especially post-COVID-19.

This narrative is true about many natural resource exporting countries in Africa today as it was of ancient Egypt of a century and half ago. In a paper titled, “Commodity Prices and Growth in
Africa”, published by Angus Deaton in 1999\textsuperscript{viii} the authors narrate how Muhammad Ali, the “Founder of Modern Egypt”, attempted to industrialise Egypt on the proceeds of cotton exports. The paper showed that the nominal prices of cotton averaged $9.00 per quanta in 1853, $14.0 in 1860, reached a peak of $33.25 in 1865; and by 1870, it had returned to $18.75. The paper further noted that additional incomes from commodity price booms helped the economies of African producing countries, just as they are hurt by the loss of incomes during slumps.

As shown in Figure 4, the story about the fluctuation in the nominal prices of cotton was true in the times of Mohammed Ali as it is now. Even more telling is the fact that the real price of cotton has tended significantly downwards since 1960. This means that countries exporting the same quantities of cotton annually since 1960 receive less export revenue today than they did in 1960. This further explains the need for building local and regional value chains to enhance the beneficiation of Africa’s natural resources in Africa for the benefit of Africans.

Figure 4: Nominal and Real of Cotton in US$ (1960-2020)\textsuperscript{5}

A lot work has been done on sustainable extraction of natural resources, beneficiation, corporate social responsibility, gender inclusion, artisanal mining, and lack of transparency and corruption along the value chain, accounting for natural capital and reversing the resource curse. However, lack of policies and institutional capacity to effectively add value, diversify the economies, and implement counter-cyclical measures during commodity price boom periods continue to expose resource rich countries vulnerable to fluctuations in prices and aggregate demand for key export commodities in the global market. This makes it very difficult for primary commodity-dependent countries to effectively build resilient economies that can withstand exogenous shocks such as COVID-19.

If well managed and accounted for, natural capital could contribute 36 percent of the total wealth of developing countries worldwide\textsuperscript{xix}. The African Development Bank’s African Natural Resources Centre Strategy 2015 – 2020 estimates that Africa’s extractive resources could contribute over US$ 30 billion per annum in government revenue over the years with minerals

\textsuperscript{5} Data Source: https://datacatalog.worldbank.org (Pink Sheet Accessed on 04-05-2020)
accounting for about 70 percent of total African exports. This translates to about 28 percent of Africa’s GDP. However, according to the Gaborone Declaration for Sustainability in Africa (GDSA), neither the value of natural capital, nor the impacts of its loss are captured in the System of National Accounts (SNA), which is used by nations to measure economic activity and by decision makers to assess performance, set policy, and report on progress\textsuperscript{xv}. In addition, the ability to access financial markets is dependent on the perceived country risk which is often captured by the country risk ratings administered by Credit Rating Agencies (CRA). The CRAs mostly focus on the financial metrics of wealth at times measured by the GDP and other risks which in most cases do not account for natural capital. Movements in GDP due to exogenous shocks such as COVID-19 could lead to a deterioration in credit risk ratings of countries – hence increasing their cost of borrowing and ability to borrow. This is a double jeopardy for many African countries.

Alongside initiatives such as the African Union’s Mining Vision, Open Government Partnership, the Extractive Industries Transparency Initiative (EITI), the Kimberly Process and UNEP’s International Resource Panel (IRP)’s Sustainable Development License to Operate\textsuperscript{xxi} among others, natural capital accounting can go a long way in ensuring that African governments make the most of their natural capital and use it to promote inclusive and sustainable growth for the improvement of the quality of life for Africans.

**III. OBJECTIVES**

The seminar will bring together, policy practitioners and experts from Africa and globally to identify evidence-based policy options that can help African countries to invest in natural capital and harness opportunities for accounting for natural capital in national development planning.

Specific questions to be addressed include:

1. How has the COVID-19 affected natural capital rich countries in Africa and globally? What are the lessons for building more resilient economies in Africa post-COVID-19?

2. What policies are required to mainstream accounting for natural capital in national accounts and/or in risk ratings of countries?

3. What are the impacts of COVID-19 on Africa’s mining sector? Could investing in natural capital provide an economic hedge for resource rich-countries post-COVID-19?

4. What are the lessons from COVID-19 for the extractive sector in the discussion of risk for asset stranding in Africa?

5. Can stock of natural capital be securitized as an asset class? How can the value of natural capital be factored into the risk ratings of countries?

6. What polices are required at the national and regional levels to accelerate value addition and value chain development in Africa’s natural resource sector?
7. Can national and regional value chains build on the principles of resource efficiency and economic sufficiency lead to a greener and more inclusive development in Africa post COVID-19?

8. What policies are required to reverse the natural resource curse in resource rich countries, stem systemic corruption and illicit capital and material flows in the sector?

9. How can the African Development Bank and other MDBs and DFIs facilitate inclusive economic growth as a result of utilisation of natural capital post-COVID-19?

IV. IMPLEMENTATION

The seminar will be hosted under the Global Community of Practice (G-CoP) on policy responses to COVID-19 in Africa. The outcome of the seminar will be policy briefs that are critical to shaping policy responses of the Bank’s Regional Member Countries in Natural Capital for Africa’s economic recovery and resilience in a post COVID-19 world. In addition, ADI will work with the Partner Institutions to produce policy relevant knowledge products, including research papers from the outcomes of the seminars. All individual contributions to the seminar shall be treated under Chatham House Rules.

V. PARTICIPATION

Participation in the e-seminar is by invitation. A select group of anchor institutions, global experts and practitioners will receive invitations as discussion leaders /conversation starters and participants in the seminar. The discussion leaders will provide a short think piece addressing each question in advance of the seminar and provide 5-minute opening remarks to start the conversation.

VI. CALL FOR PARTICIPANTS

To participate in the G-CoP e-seminar on Financing Natural Capital: Policies for Value Chain Development in Natural Resources in Post COVID-19 Africa, please register here (Click here) or send an email to adigcop@afdb.org.

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xii International Institute for Sustainable Development (IISD), 2019.


