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Investment: Unlocking Africa's Potential

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A. Investment : Key Political Messages and Action Points

It is now time to invest in Africa. The prospects are good. Africa is already attracting growing flows of private resources, as a result of its greater political stability and economic reforms. Significant new investors are now engaging in Africa, from within and outside the continent. Development assistance and debt relief alone will not be sufficient to achieve the Millennium Development Goals. Africa now needs more and sustainable investment, both domestic and foreign, in order to accelerate economic growth and progress in poverty reduction, and become better integrated into the global economy. **We call for** the fulfilment of commitments made at African and G8 Summits and other global fora, including support from development partners to help Africa mobilise more investment, and better focus on mobilisible domestic revenue sources and indigenous resources. Areas such as infrastructure, extractive industry, tourism, agribusiness and ICT are particularly important drivers of development, and require support from development partners.

1. **Efficient finance sectors** are needed, in order to broaden access to financial services for the poor, and respond to the needs of small and medium enterprises, in order both to help boost economic growth and to spread its benefits to all. **We call for** a new initiative, such as a special financial facility, to increase **micro-financing opportunities**, both for the poor and in particular women ('finance for all'), and for growing small and medium enterprises ('finance for growth').

2. **Domestic investment** is essential for sustainable economic growth. We welcome the progress which has already been made in improving the domestic investment climate. **We call for** continued and intensified efforts to **simplify and improve economic regulations**, and greater political support for investment-related activities in national plans of action in countries reviewed under the APRM process.

3. A **variety of risks** continues to hold back increases in investment. **We call on** multi-lateral and bi-lateral donors to review and adapt their **guarantee schemes**, and develop new instruments to cover, for example, local currency risks and loans to the agricultural sector. We call on international insurance companies to offer **basic insurance** products for the rural poor, for instance insurance of agricultural production risks resulting from climate change, and for greater attention on risk mitigation for private sector involvement in contract farming.

4. **We have developed new forms of cooperation** for improving the investment climate in Africa, such as the Investment Climate Facility (ICF), and the Infrastructure Consortium for Africa (ICA), which focuses on investment in infrastructure. **We call for** the **accelerated implementation** of these new mechanisms, including the strengthening of the ICA as a framework for scaling up investment in infrastructure, and for more financial support to the ICF to enable it to meet its targets. We also call for broader support for the African Development Bank's Project Preparation Facility.

5. **Regional integration** is also important for attracting investment. Regional Economic Communities need the capacity for instance to prepare and facilitate regional infrastructure projects, and to create the right policy environment. **We call for** a new joint initiative, from both regional institutions and development partners, to help build this **capacity**, and for support for efforts by regions to harmonise **business regulations** and create common platforms for regional **investment promotion**.

6. **Continued improvements in economic governance and corporate responsibility** will help both to generate sustainable investment and to bring about wider social and economic benefits. **We call for** additional partners to join existing **transparency** initiatives, including the Extractive Industries Transparency Initiative, for the full ratification and implementation of the **UN and AU Conventions against Corruption**, and for strengthened action both to implement the OECD **Anti-Bribery Convention** and to detect, recover and return **illegally acquired assets** held outside Africa.

B. Investment : Unlocking Africa's Potential

Introduction

1. Mobilising private investment is the key to unlocking the vast potential for accelerated economic growth and development in Africa. There is a positive story to tell. A significant improvement in the policy and institutional environment in many countries has led to the revival of private flows of resources, and this has in turn helped to generate sustained and increased growth over the last 10 years. The flow of capital to the continent is increasing rapidly, particularly from export income, remittances from the diaspora, and from inward foreign direct investment (FDI). FDI inflows alone reached US$ 31 billion in 2005, which represents a 78% increase over 2004. Average growth rates in Africa now outstrip average global growth rates, with a rate of over 5% in the past 3 years. 17 African countries have recorded annual growth of more than 5% over the past decade.

2. Further increasing the levels of both domestic and foreign investment will be critical to achieving the accelerated increases in growth which Africa needs – to generate employment and jobs in both the urban and rural sectors, to accelerate progress towards the Millennium Development Goals (MDGs), and to build the inclusive societies on which political stability depends. There are enormous opportunities. Investment resources are available, domestic banking institutions are highly liquid, there is untapped domestic savings potential as well as significant holdings of wealth overseas. In addition, major new investors from emerging economies are now engaging in Africa. The issues which need to be addressed to unlock these opportunities are common to both domestic and foreign investment. Indeed, one of the central challenges is how to increase domestic investment by keeping more wealth and savings in Africa, as well as increasing the level of foreign investment.

3. African leaders have developed a clear vision emphasising the importance of sustained economic growth through private sector development, which is shared by their development partners in the international community. More needs to be done to continue to translate this vision into reality. **The purpose of this paper, therefore, is to focus on how Africa and the international community can address the critical bottlenecks to investment, and thereby help unlock Africa's enormous economic potential in support of development**. It recognises that the picture, of course, varies significantly across the continent. However, two important themes run through the paper: firstly, the importance of taking action in Africa, not just at the national but also at the regional level; and secondly, the need for active support from the international community for Africa's efforts to improve its investment climate.

4. **Section I** of the paper summarises the key commitments of African governments and their development partners. **Section II** reviews progress with reform, growth and diversification of sources of finance. **Section III** assesses existing bottlenecks to increased investment. **Section IV** looks at the actions needed to overcome these and to "Unlock Africa's Investment Potential". These actions are divided into **3 main areas**: improving the regulatory environment and economic governance; developing financial markets; and developing infrastructure – including regional and rural infrastructure. **The main points in each of these areas are summarised in the rest of this introduction, and the key action points are indicated in a matrix of recommendations.**

5. **The regulatory environment and economic governance**. Real progress has been made in reducing the complexity and cost of regulation, improving transparency and tackling corruption. Africa is the third fastest-reforming region in terms of simplifying its economic regulations. It is important that this progress should be recognised more widely. However, there is more to be done in order to make Africa a better place to do business and to improve perceptions and confidence among domestic and foreign investors. The lead on this needs to be taken by ***African governments***, building on best practices, in order to simplify and improve economic regulations in labour and product markets and in taxation and customs administrations – along the lines set in last year's economic report from the UN Economic Commission for Africa and this year's "Doing Business Report" from the International Finance Corporation. Governments

also need to strengthen the rule of law and the enforcement of contracts in order to reduce uncertainty, to improve and enforce anti-corruption laws and regulations, including the Extractive Industries Transparency Initiative (EITI), and to look for ways to demonstrate that they will lock in good policies and sound implementation in order to build investor confidence. The APRM – an African owned peer review process – has a key part to play in this area. There are also steps which ***the international community*** needs to take to help reinforce efforts in Africa to combat corruption, for instance by: completing ratification of the UN Convention against Corruption and translating its provisions into national laws, policies and practices; reinforcing monitoring of the implementation of the OECD Anti-Bribery Convention, and ensuring the vigorous implementation of its commitments to tackle the problem of money laundering through action to detect, recover and return illegally acquired assets. In addition, development partners can develop capacity building programmes and tools for improving the business climate such as the Investment Climate Facility (ICF) and the Policy Framework for Investment (PFI).

6. **Developing financial markets.** Progress here will allow African economies to achieve greater depth, and to increase their capacity to absorb economic shocks. This is important in a context of growing capital imports, as strains placed upon currencies and exchange rates could compromise the crucial benefits of a stable macro-economic environment. It would also be an important means of reinforcing the financial capacities of the local economy and diversifying investment options for domestic and foreign investors. Again, the lead can only be taken by ***African governments*** themselves, at a number of levels. These include the regional integration of capital markets in order to expand portfolio opportunities and thereby reinforce both domestic and international investment, as well as increasing the positive impact on development; and strengthening access to credit by stimulating competition in the banking sector. ***Development partners*** have an important part to play in supporting such African-led efforts – for instance by helping countries integrate into global financial markets in a secure and sustainable way with appropriate safeguards, by developing new guarantee schemes and insurance products to cover certain portfolio investments as well as loans to small and medium-sized enterprises ("finance for growth"), and by launching a new initiative to increase micro-financing opportunities for women, the poor and the agricultural sector ("finance for all").

7. **Developing infrastructure – including regional and rural infrastructure**. One of the main reasons why Africa still lags behind other regions in the cost of doing business is the lack and poor quality of transport and energy infrastructure – which places a heavy burden both on business costs and on household incomes. Africa is moving in the right direction, and development partners are increasing their financial support after stagnation over the last decade. But more needs to be done at a number of different levels – including through a strong push for investment in regional transport and energy infrastructure, plus an emphasis on investment in rural infrastructure – which is key to helping unlock the potential of the agriculture sector, on which a large proportion of Africa's population depends. ***African governments*** should accelerate progress towards regional economic integration in order to increase the size of markets, and the viability of infrastructure investment projects. Advanced planning for infrastructure projects also needs to be improved. Continued efforts are needed to make more efficient and effective use of existing infrastructure. ***Development partners*** need to sustain the recent trend of increasing investment in infrastructure, work with African countries to mobilise additional resources and support a strengthened focus on regional infrastructure through a capacity building initiative for Regional Economic Communities (RECs).

Matrix of Key Policy Areas and Action Points on Investment

KEY POLICY AREAS	KEY ACTION POINTS	
	African governments	**International community (and the private sector)**
Regulatory environment and economic governance	Simplify/improve labour laws, tax regulations and customs regimes, including through the APRM Strengthen rule of law and judicial systems: improve and enforce anti-corruption laws and regulations, including EITI	More benchmarking of regulatory environments such as "Doing Business Reports" to reinforce perceptions of progress Strengthen action to tackle bribery, corruption and money laundering – through UN Convention against Corruption, OECD Anti-Bribery Convention, and recovery/restitution of illegally acquired assets
Developing financial markets	Develop domestic and regional financial markets Address the needs of the informal sector and SMEs through improving competition policy in the banking sector	Develop guarantee schemes and insurance products to cover, for example, certain portfolio investments and loans to SMEs and the agricultural sector ("finance for growth") Launch a new initiative to increase micro-financing opportunities for the poor and in particular women ("finance for all")
Developing regional and rural infrastructure	Accelerate regional integration to increase market size Give greater emphasis to rural infrastructure in national and regional strategies and budgets – to help meet needs of agriculture sector	Launch a capacity building initiative for RECs to prepare and facilitate regional infrastructure projects Tackle risk aversion through guarantee schemes for private investment in infrastructure

I. Context

8. Growth in Africa has exceeded 5% for three years in a row. This trend represents a turning point after several decades of economic stagnation. It is based upon the raw materials boom, but also upon the political and economic stabilisation of the continent. Many countries have implemented democratic transition processes[1] and the African Peer Review Mechanism (APRM) ensures that participating states abide by common values in relation to socioeconomic development and political, economic and business governance. Alongside this, economic reforms and stabilisation have improved the business climate.

9. Yet Africa will need to achieve a 7% growth rate to achieve the Millennium Development Goal (MDG) of halving the proportion of people living on less than US$ 1 per day[2] and the growth rate depends largely upon the level of investment.[3] Yet in 2005 investment in Africa, as measured by the ratio of gross fixed capital formation to GDP, was still stuck at 19%,[4] whereas an investment rate of between 22% and 25% of GDP would be necessary to achieve growth of about 6%[5] – and just nine African countries achieved such a result in 2005.[6] Official Development Assistance (ODA), including debt reduction, will not suffice to bridge this gap. It is therefore essential that domestic and foreign private investment continues to increase so that African growth accelerates.

10. While investment in Africa may therefore rely upon the commitments of African governments and their development partners (section II) as well as progress with reform and growing capital flows (section III), it continues to come up against major problems of economic governance, infrastructure and credit (section IV), which require targeted initiatives (section V).

II. Investment at the heart of numerous international commitments

11. African countries and the international community now put investment at the forefront of their development priorities. Many action plans and declarations adopted at international summits place particular emphasis on the need to mobilise private investment and resources to bolster development.

- The Cairo Plan of Action, decided at the Africa-Europe Summit held under the aegis of the Organization of African Unity (OAU) and the European Union (EU) on 3rd and 4th April 2000, has already established numerous investment priorities. In particular, it provides for the creation of an environment conducive to the development of the private sector; the improvement of the regulatory framework with business communities; the launch of programmes to promote FDI; support for South-South cooperation on mergers and acquisitions and the reinforcement of African financial instruments and markets; and cooperation to tackle the problem of capital flight, including offshore banking centres.[7]

- The NEPAD declaration approved at the African Union summit in Lusaka in July 2001 identifies the inadequate accumulation rate as the main problem underlying African under-development (paragraphs 22 and 25). On the other hand, it establishes a link between the level of investment and wealth creation on other continents (paragraph 20). Lastly, it stresses the need to mobilise private domestic and foreign investment in support of development (paragraphs 34 and 35).[8]

- At Monterrey in March 2002, the United Nations agreed to redouble their efforts to help unblock and make more efficient use of all those resources necessary to development, notably domestic and foreign private investment[9] – particularly through the improvement of the business climate.

- At Kananaskis, the G8 countries approved the Africa Action Plan, one of whose priorities is to support sustainable growth by helping Africa to increase domestic and foreign investment, to build capacity in infrastructure project development and to encourage regional economic integration.[10]

- At Gleneagles in July 2005, the G8 leaders also agreed to stimulate growth, to improve the investment climate and to make trade work for Africa, particularly by endeavouring to reinforce Africa's commercial capacities and to mobilise the investment in infrastructure required by business.[11]

III. Progress with reform, growth and diversification of sources of finance

12. Following the reforms launched in the 1980s, Africa initially succeeded in stabilising its political and macroeconomic environment. From the second half of the 1990s onward, current account deficits were generally contained, if not reduced, and macroeconomic indicators moved in the right direction: inflation has been below 5% since the beginning of the new millennium;[12] growth has exceeded 5% for three years in a row and 17 countries have even achieved an average growth rate of 5% throughout the past decade; and the debt burden has been falling since 1995,[13] thereby reducing budgetary pressures. Democratic reforms have also made progress across the continent[14] and conflicts have diminished sharply since 2002.[15]

13. Given the role of political change in reforms of economic regulations,[16] it is scarcely surprising, in addition, that major changes in the business environment have come hand in hand with democratic transition. Sub-Saharan Africa (SSA) is actually the region of the world that has reformed its economic regulations the most, apart from Eastern Europe and the OECD countries, thereby moving up from last place to third.[17] Two African countries (Ghana and Tanzania) are among the ten leading reformers at the global level.[18] In February 2006, Nigeria also became the 110th sovereign state to be rated by Standard and Poor's and the 14th in Africa. 2005 was a good year for those states that are rated: progress was noted in economic policy and in structural reforms, leading to improvements in the ratings awarded to Egypt, South Africa and Morocco.[19]

14. Combined with the increase in raw materials prices, which has benefited the extractive industries, these changes seem to have had an impact upon both foreign and domestic investment. While the ratio of gross fixed capital formation to GDP increased from 17% in 1990 to 19% in 2003-05,[20] foreign direct investment (FDI) reached a peak of US$ 31 billion in 2005, equivalent to a 78% increase compared to 2004.

15. Alongside the joint effects of reform, the raw materials boom and renewed interest from international partners, inbound capital flows to Africa are increasing and diversifying rapidly. In fact, the financing of African development can now rely upon:

- Much higher revenues from fossil and mineral raw materials, benefiting from the strong demand from emerging countries, particularly China, whose trade with Africa has increased fifty fold in 25 years,[21] reaching US$ 40 billion in 2005, then US$ 55.5 billion in 2006;[22]

- Foreign direct investment (FDI) flows that have grown at an unprecedented rate (see below);

- Remittances from migrants that were officially put at US$ 19.2 billion in 2004[23] and that are no doubt much higher, given that the weakness of financial systems and the cost of formal transfers encourages informal remittances;[24]

- Resources provided by regional and international capital markets, to which both development banks and commercial banks and companies can have access,[25]

- Official development assistance that has started to grow again,[26] despite treading water in 2006;

- Commercial loans, all the more likely to increase given that many countries are returning to solvency[27] and the pool of potential lenders is expanding, although rigorous attention must be paid to debt management;

- Domestic revenues, the growth in which relies upon an improvement in the economic context.[28]

The Boom in Foreign Direct Investment

FDI in Africa reached US$ 31 billion in 2005, surpassing bilateral ODA for the first time. This represents a 78% increase over 2004, an all-time record and a growth rate higher than both the global FDI figure (29%) and the figure for foreign investment in the developing countries.[29] We must also note that private capital flows to Africa, and more particularly flows of FDI, are greatly under-estimated because of the rudimentary nature of the monitoring systems in place. According to the results of projects carried out in 18 African countries, it may be that private flows are two to three times higher than official figures".[30] Furthermore, even abiding by these figures, Africa is attracting as much FDI as South-East Asia as a proportion of GDP.[31]

While FDI in Africa continues to be principally concentrated in the extractive industries, the current upsurge is affecting more countries and more sectors than ever before.[32] While food processing, textiles and services now attract a growing proportion of foreign investments, new source countries – such as China, India, Malaysia and South Korea – are making a conspicuous entrance into the investors' club. While their asset portfolios remain smaller than those of Europe or the United States, they do account for an ever larger proportion of flows.[33] In addition, contrary to received wisdom, these are certainly not limited to the hydrocarbons sector. For example, 46% of Chinese investment in Africa between 1979 and 2000 was in the manufacturing sector.[34]

Certain countries, such as Kenya, Uganda and Tanzania have recorded some of the highest rates of FDI growth among developing countries – almost US$1 billion in the past 2 years.[35] This growth must also be put down to the regional integration work carried out by these countries.

16. Yet the data and statistics also suggest that a growing differentiation is dividing those countries that are achieving substantial progress from those that are stagnating, or even losing ground.[36] Whereas 13 African countries saw their income per inhabitant multiply by one and a half to nine fold between 1960 and 2004, nine other countries now have a lower per capita income than in 1960. Furthermore, the countries' performance varies according to their size: the four largest SSA countries, home to 42% of the population of the sub-continent, account for just 3.4% of its income. Alongside this, countries placed in comparable geographical situations (e.g. coastal countries under-endowed with natural resources or landlocked resource-rich countries) have followed extremely diverse trajectories.[37] This all seems to confirm that the policies implemented have a major impact upon the outcomes achieved in terms of growth and investment, a fact that is also highlighted by numerous studies.[38] Thus, it seems important that the principal obstacles to investment growth are properly identified in order to ensure that they can be overcome.

IV. Difficulties affecting investment in Africa

17. The decision to invest principally depends upon the business climate, which itself involves many parameters including: macro-economic, institutional and political frameworks; economic regulation and its implementation; well-defined property rights, as well as functional legal, contractual and financial systems; and appropriate high-quality infrastructure. Yet, while the African countries have generally made significant progress in certain key areas, such as political and economic stabilisation, many obstacles continue to hinder the establishment of a climate conducive to investment on the continent.

18. The difficulties that hinder investment in Africa relate in particular to: deficient economic governance, which leads to significant capital flight (a); a lack of savings and the inadequacy of financial markets – affecting both the finance needs of firms and those of the informal economy, agriculture and women entrepreneurs (b); and to the lack or poor quality of infrastructure (c).

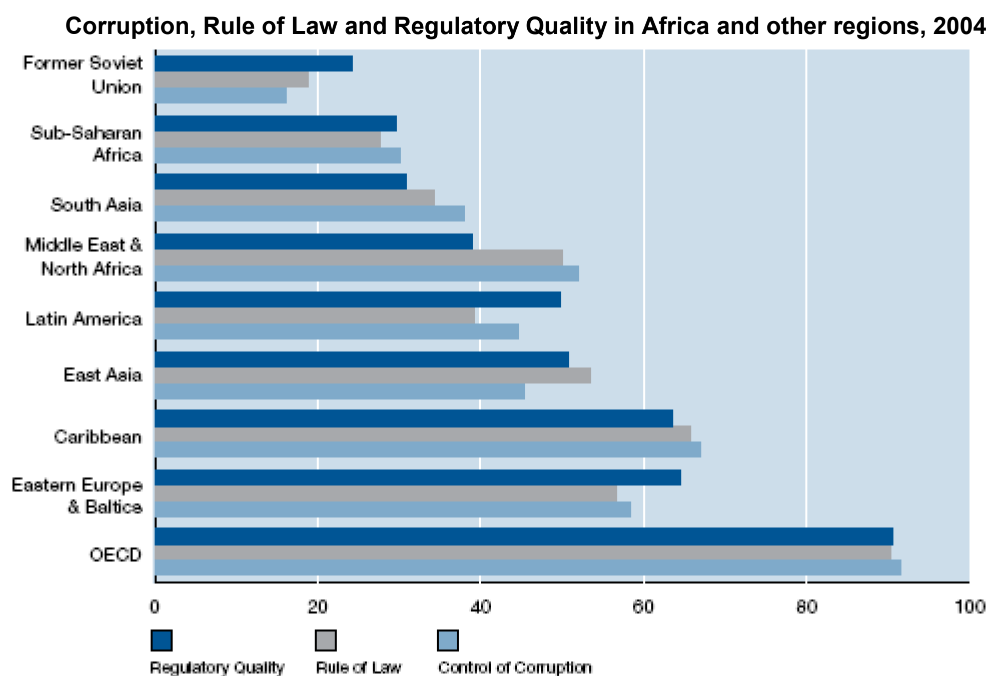
a) Deficiency of economic governance and capital flight

19. Despite significant progress in certain parts of the continent, many countries continue to be characterised by great weaknesses in relation to economic governance and regulation. Corruption, which generally heads the list of reasons cited by transnational companies to justify their refusal to invest in Africa,[39] is the most obvious symptom of this. Yet it is also entrenched in the weakness of institutions and in the complex and cumbersome nature of economic regulations.

Weak institutions, cumbersome and complex economic regulations

20. As demonstrated by the figure below on corruption, the rule of law and regulatory quality, together with the former Soviet Union, Africa is the region of the world that is suffering the greatest deficiency of governance. There is no doubt that this constitutes a major obstacle to investment.

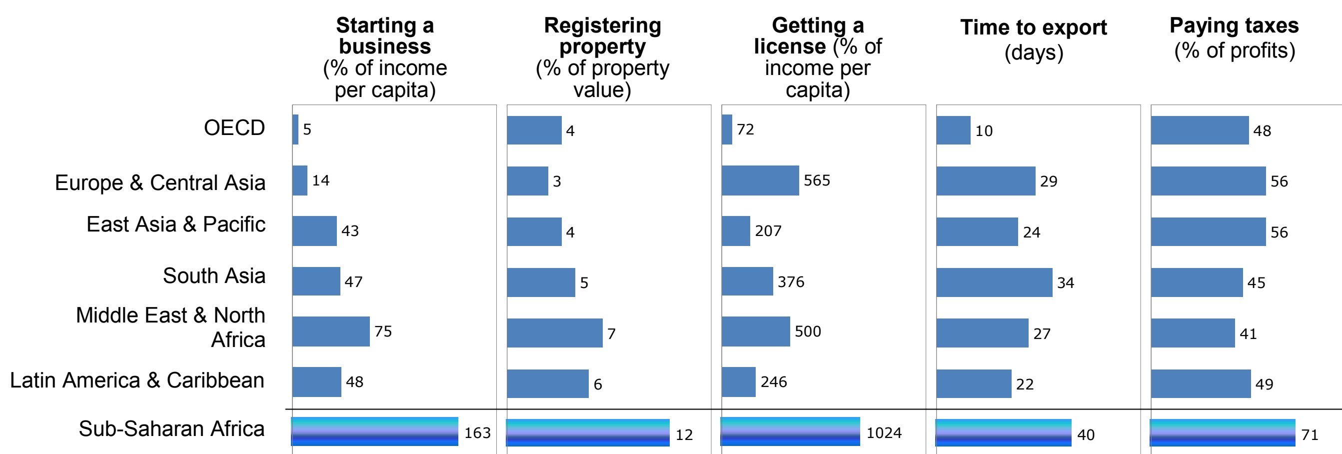
Corruption, Rule of Law and Regulatory Quality in Africa and other regions, 2004



Source: Kaufmann, Kraay, and Mastruzzi 2005.

21. Because of its economic regulations, Africa also has the world's highest cost of doing business (c.f. figure below).

Highest Cost of Doing Business in the World



Source: Doing Business in 2007

22. The complex and cumbersome nature of economic regulations in Africa is clearly likely to hold back the development of private enterprise. The time taken for customs processes is comparatively long, there are numerous inspections and a great deal of time is taken over administrative tasks. As indicated in the table above, this extends the amount of time required to carry out economic transactions. By necessity, this encourages firms to remain in the informal sector.

23. With regard to the time taken over customs clearance, in particular, this is all the more likely to discourage investment when the accumulation of physical capital is more heavily dependent upon imports in Africa than on other continents. Together with the tightness of the domestic market, this is a second key factor that tends to reduce flows of FDI to Africa.

24. As for labour regulations, these do not constitute a major obstacle in heavily capital-intensive industries such as the extractive industries, but they do represent an important factor in the manufacturing sector. Yet not only does Africa have to increase investment in order to achieve faster growth, but it also needs labour-intensive investment and growth that creates jobs so that the majority – particularly the poor, women, and young people – can reap its benefits; and, according to World Bank estimates, Africa is the developing region where there are the greatest labour market rigidities.[40]

Capital flight

25. The weakness of institutions, governance and economic regulations in Africa has the particular consequence of stimulating a major flight of capital, originating both from corruption and from poor economic prospects. These phenomena, together with the scale of invisible savings, demonstrate that there remains potential for mobilising untapped domestic resources, provided that an improvement is made in the business climate – in particular with regard to institutions and to economic regulations.

26. As for stolen African assets held in foreign bank accounts, the Commission for Africa created by the United Kingdom has valued these at more than half the continent's external debt.[41] Yet capital flight is not limited to assets stolen from countries rich in mineral and fossil resources. Without seeking to make a

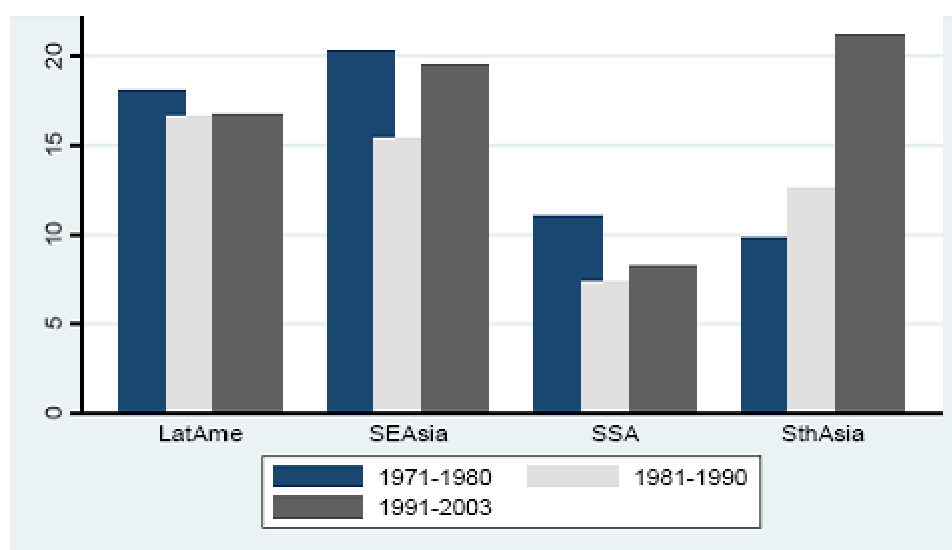
distinction between the proceeds of corruption and those of capital flight associated with a lack of business opportunities, certain authors have shown that the amount of private assets held abroad by 25 low-income countries from Sub-Saharan Africa exceeded the amount of public debt owed by those states, making them net creditors vis-à-vis the rest of the world![42] A recent World Bank study on the growth challenges of Africa also stresses that in 1990 Africans held assets worth US$ 360 billion outside the continent, equivalent to 40% of their wealth, compared to 6% for East Asia and 10% for Latin America.[43]

b) Inadequacy of savings and dysfunctioning financial markets

A very low savings rate

27. Investment boils down to the residual savings rate net of consumption. Savings are therefore the principal parameter to take into account when examining domestic investment. Indeed, the savings rate in Africa is generally very low. While it was higher than that of South Asia during the 1970s, it averaged no more than 9% of GDP in 2003, compared to 20% in South Asia and the African average even falls below 5% if one excludes those countries that are rich in natural resources.

Saving Trends: Regional Comparison by Decade



Source: World Bank, World Development Indicators 2006.

28. In part, this finding reflects how savings grow automatically as incomes rise – and the difficulty of saving when income constraints are too great. It also illustrates the impact of the demographic shock that Africa has experienced over the past thirty years. The rate of demographic growth in Sub-Saharan Africa is actually the fastest in the world, with the population of many countries doubling every twenty years. In this context, the choices made by the population are giving precedence to the division of goods, labour and incomes, to the detriment of capital and productivity growth.

29. Aside from income constraints and demographic growth, to which we must add the political and economic risks of capital being lost or suffering depreciation, dysfunctioning financial markets constitute another factor explaining the weakness of the official savings rate.[44]

The dysfunctioning of financial markets

30. Poorly functioning financial markets represent a major obstacle to the mobilisation of savings in order to promote investment in Africa. Following the debt crisis, the cleaning up of the banking sector had the effect of reducing the number of financial institutions. In many states, the banking sector has an

oligopolistic structure that explains both the growing interest rate differential between Africa and the rest of the world and the increasing disparity between credit interest rates and the remuneration level for deposits (see table below).[45] In addition, the financial products provided by the banks are generally few in number. It seems obvious now that the clean-up of the financial sector was sometimes achieved at the expense of a loss of efficiency in financial intermediation.

Interest rate spreads and interest rate differentials in selected African countries

	Interest rate spread			Interest rate differential with the US		
	1980-89	1990-95	1996-2003	1980-89	1990-95	1996-2003
Algeria	n.a.	3.0	3.0	-9.1	-17.1	2.7
Kenya	3.5	9.0	13.3	-3.1	-2.0	5.8
Malawi	7.6	7.6	20.4	-9.2	-9.9	9.2
Nigeria	2.4	6.6	8.2	n.a.	-37.8	0.0
Seychelles	5.8	6.3	6.5	2.9	12.3	2.3
Sierra Leone	7.0	14.9	15.7	-53.4	-21.9	4.5
South Africa	3.8	4.0	5.0	-5.1	0.8	4.3
Swaziland	5.8	6.2	7.4	-5.9	-1.9	1.1
Tanzania	9.7	15.9	15.3	n.a.	5.0	-2.5
Uganda	7.9	7.4	11.4	-94.3	1.4	4.9
Zambia	5.7	15.4	18.1	-52.8	-43.7	7.2
Zimbabwe	7.9	3.2	22.3	-8.4	-4.1	-10.3

Source: Calculated using data from IMF 2005.

***Note:** The averages are computed from quarterly series. The interest rate differential for an African country is obtained by subtracting the US real interest rate from the African country's real interest rate.*

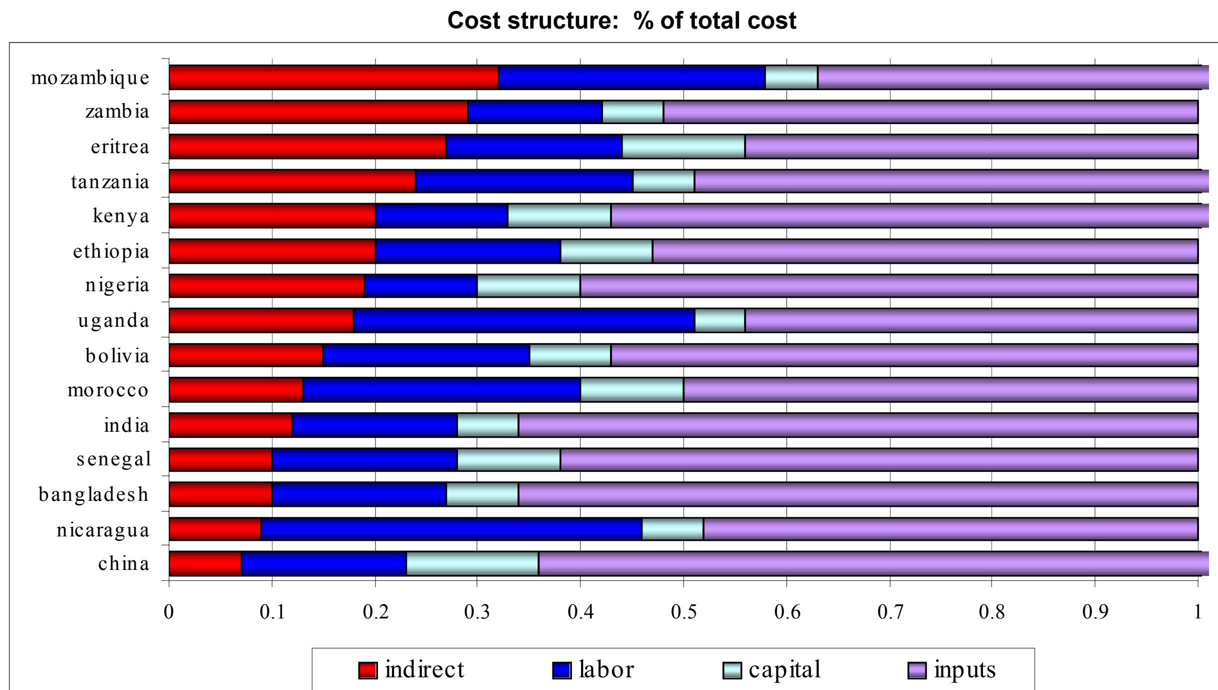
31. The inefficiency of the financial system reduces foreign investment flows – according to a survey of multinational businesses, 28% identified finance problems as one of the main obstacles to the development of FDI in Sub-Saharan Africa, in third position behind corruption (49%) and access to the international market (38%)[46] – with knock-on effects on economic growth.

32. Yet difficulties in accessing credit are a particularly heavy burden for the poor, women entrepreneurs, artisans and micro, small and medium-sized enterprises that constitute the overwhelming majority of the productive forces of Africa. For all these players, the physical, administrative and economic barriers to entry to the banking sector place a fundamental limit upon their capacity to invest.

c) Weakness of infrastructure

Poor quality and inadequacy of infrastructure

33. Many African countries rack up the dual handicap of having income levels that are among the lowest in the world and utility costs (water, electricity, transport and telecommunications) that are among the highest. This situation arises from the lack of high quality infrastructure,[47] affecting the levels of households' savings and business profits, which in turns depresses investment. In fact, the World Bank estimates that infrastructure and security costs account for 20% to 30% of operating costs in Africa, compared to 10% to 15% in India and China.[48]



Source: Eifert, Gelb and Ramachandran, *Business Environment and Comparative Advantage in Africa: Evidence from the Investment Climate*

34. Alongside this, the smaller the size of firms, the heavier the burden of infrastructure costs on their operating accounts. To take just one example, that of electricity, it is clear that the poor quality of the grid constitutes one of the main obstacles to conducting business and to the development of SMEs on the continent. While Africa is the continent that has the highest proportion of firms with generators, these are actually less easily accessible to SMEs and micro-enterprises than to large companies.[49]

Obstacles to the development of infrastructure

35. While the continent's infrastructure needs are massive,[50] public investment only has limited potential. There are still significant budgetary constraints in most African countries, while the proportion of total bilateral ODA allocated to infrastructure fell from 35% to 15% between 1985 and 2003[51] - and now stands at about US$ 10 billion. Even if that aid were significantly increased, it would remain well below what the continent needs in order to be able to support sustained investment and growth. These facts argue in favour of increased private investment in infrastructure, particularly as such investment generally involves a certain expertise and capacity for management.

36. Africa is also the continent in which private investment in infrastructure is growing most quickly, particularly in telecommunications and, to a lesser extent, in energy,[52] although the transport sector and water and sanitation, in particular, are still financed overwhelmingly from public funds.

37. The principal obstacles to such development include:

- Inadequate preparation for many infrastructure projects at a "bankable" stage;
- The inadequacy of resources/lack of upstream preparation - the defects of the regulatory environment at the national level, the lack of legal harmonisation for transnational projects, the inadequacy of negotiations or consensus between states;
- The inadequacy/dispersal of resources for feasibility studies to prepare for regional projects;

- The long timeframe for returns on investment and the scale of the commercial and political risks associated with infrastructure projects;
- The lack of national and sub-regional capacity to negotiate Public-Private Partnerships (PPP);
- Market size.

V. How should Africa forge ahead?

38. Stimulating private investment is the best means of unlocking Africa's vast potential for growth and development. Investment requirements are enormous and private resources are much greater than public funds. The latter should therefore be used in a targeted manner in order to leverage private investment.

39. Firstly, improved economic governance and regulations (a) would better allow the resources available to be channelled so as to support sustainable investment and growth that creates employment. FDI would then be able to continue to grow, particularly in the manufacturing sector, while domestic savings might contribute a little more to domestic investment and a little less to capital flight.

40. Secondly, the development of financial markets (b) could consolidate the macro-economic stabilisation process and meet the financial needs of the informal sector, women entrepreneurs and SMEs, again increasing potential investment growth.

41. Thirdly, the development of infrastructure (c) via measures designed to increase private finance should also reduce costs and thereby increase business investment. Lastly, it seems that agriculture, which still employs the majority of African workforce, must be the subject of specific initiatives designed to increase its resources and profitability.

a) Improving economic governance

42. Certain countries such as South Africa, Egypt, Senegal, Uganda and Kenya have increased their transparency and reduced the complexity of their tax systems.[53] Others, such as Mauritius, Namibia, Botswana, Ghana and Tanzania, have simplified business regulations, which has led to a spectacular reduction in the time required to effectively do business.[54] Such initiatives should be pursued and followed by all African countries. They have the capacity to produce a considerable improvement in the business climate. The OECD countries should also lend their support here.

African countries should:

- Simplify their economic regulations and tax systems, notably by establishing one-stop-shops for the creation of businesses or the completion of customs formalities or by reducing registration costs;
- Review tax reductions and exemptions for extractive industries at the regional level;[55]
- Simplify labour legislation so as to encourage investment in highly labour-intensive sectors such as food processing, manufacturing activities and services;
- Achieve deeper regional economic integration so as to increase the mobility of production factors and the trickle-down effects of FDI for local producers;[56]
- Increase their to achieve transparency and to combat corruption, for example by signing up to or implementing the Extractive Industries Transparency Initiative (EITI) – Nigeria is the only one of the fifteen African signatories to have fulfilled all its commitments under the initiative, notably the publication of audited, reconciled reports.[57]

OECD countries should:

- Engage in a dialogue with the emerging economies about reinforcing international standards of corporate governance, for example by supporting the EITI, by complying with OECD guidelines for multinational enterprises or by signing up to the OECD Anti-Bribery Convention;

- Combat corruption by:

    - Translating the United Nations Convention Against Corruption into national laws, policies and practices (and by ratifying it in the case of those countries, particularly among the G8, who have not done so);
    - Reinforcing the OECD Anti-Bribery Convention (by applying it to their local partners);
    - Implementing the Agreement of G8 Justice and Interior Ministers to detect, recover and return illegally acquired assets;[58]

- Speed up the implementation of the African Investment Climate Facility (ICF);

- Support and coordinate evaluation/rating processes and quality indicators covering the regulatory environment (there are many indicators issued by different institutions: World Bank, UNIDO, UNCTAD, OECD, UNDP, Standard & Poor's, Moody's etc.) so as to increase incentives for reform;

- Encourage companies from OECD and emerging countries to pursue dialogue designed to develop voluntary initiatives such as codes of conduct on investment quality.[59]

b) Reinforcing financial markets

43. Firstly, it is important to develop capital markets (particularly at the regional level) in order to manage the achievement of macroeconomic stabilisation;[60] to increase potential finance for the local economy[61] and to diversify investment options for domestic and foreign investors.[62] Alongside this, the financing of SMEs, female entrepreneurs, the poor and artisans requires that the conditions of access to bank credit should be made more flexible and that the commercial banks should provide a wider range of products and specific micro-financing initiatives.

African countries should:

- Achieve deeper economic and financial integration at the regional level, notably by developing regional capital markets so that they overcome the narrowness of national markets;

- Reinforce rules on competition and increase the flexibility of guarantees (particularly property guarantees) required in the banking sector.

The international community should:

- Support the development of regional capital markets, for example by guaranteeing certain investments, particularly against foreign exchange risk;[63]

- Promote access to credit for the poor, women, micro-entrepreneurs and SMEs through initiatives to support micro-finance, guarantee mechanisms for loans to SMEs[64] and facilities designed to diversify the financial products on offer to small and medium-sized enterprises and farmers.[65]

c) Developing regional and rural infrastructure

44. By a large margin, there are insufficient public resources to meet the enormous investment needs of the African continent. The development work of African governments and their development partners should therefore be focused on increasing private investment in regional and rural infrastructure.

African countries should:

- Speed up regional economic integration so as to increase market size and improve the viability of infrastructure.
- Improve advance planning for infrastructure projects, particularly by negotiating and harmonising the regulatory framework at the sub-regional level.
- Develop rural infrastructure so as to increase the profitability of the sector – which would be achieved by increasing the agriculture budget, in accordance with the Maputo objectives, which state that it should be increased to 10% of public expenditure.

The international community and the multilateral financial institutions (MFIs) should:

- Launch an initiative to reinforce the capacity of regional economic communities (RECs) to plan regional infrastructure projects;
- Reinforce the Infrastructure Consortium for Africa (ICA) as a platform for dialogue to identify the principal obstacles to infrastructure development and the means of making progress;
- Increase resources/integrate certain facilities for the upstream preparation of regional projects;
- Use guarantee mechanisms, such as partial credit guarantees, in order to reduce the risk aversion of investors.

Enhancing Private Sector Investment in the Agricultural Sector

CAADP recognizes the important role the private sector is expected to play in the development of the agriculture sector in Africa. The following constraints are impediments to improve the increase of contract farming: (1) lack of appropriate legal and institutional frameworks, (2) poor infrastructure, (3) weak or undeveloped commodity grades and standards, (4) weak and poorly organized farmer organizations, (5) unfair international trade agreements, and (6) inadequate demand-driven research and extension systems.

In order to enhance the contribution of contract farming to economic growth and poverty reduction, African governments and other stakeholders should immediately pay attention to the following:

- Development of appropriate legal, policy and institutional frameworks including workable and enforceable contract mechanisms;
- Facilitate the harmonization of national and regional policies, legislations and institutions relevant to contract farming;
- Formation of multi-stakeholder-based country task forces on contract farming to kick-start the harmonization process;
- Enhance partnerships, networks and linkages between various stakeholders as a mechanism for addressing the multidimensional capacity constraints facing contract farming;
- Facilitate the evolution of effective and efficient farmers' organizations to influence equitable distribution of risks and benefits between farmers and agribusiness firms;
- Create favourable market conditions to improve market access and develop and/or strengthen market information systems at national, regional and continental levels;
- Accelerate efforts to reduce or eliminate formal and informal trade barriers;
- Align national and regional infrastructural planning and development with the infrastructural demands of contract farming;
- Continuous monitoring and assessment of the impacts of contract farming on poverty reduction, competitiveness of agriculture, environment, gender, and equity, and
- Accelerate implementation of the CAADP agenda for further improvement of the environment for the private sector development taking into account the specific needs of contract farming.

Most of these interventions have to be implemented at the national level, where there are several sources of development funds, such as national budget, grants, and loans. However, national action will generally require complementary interventions at sub-regional (RECs), NEPAD, and AU levels. These interventions can include ensuring agreement on shared commodity priorities, trade facilitation and simplification of barriers to trade, common policies on support to agriculture and agro-industry, codes on incentives for private investment promotion etc.

Notes

[1] United National Economic Commission for Africa (UNECA): African Governance Report, 2005.

[2] http://www.uneca.org/omd/Story31Oct06.asp

[3] Investment is essential to growth: it actually plays a major role in increasing productivity, which in turn is crucial to growth. Bosworth and Collins calculate that total factor productivity growth generates 41% of the growth in the 84 countries that they have studied: c.f. Bosworth, B. and S.M. Collins, 2003: "The empirics of growth: An update", Brookings Papers on Economic Activities.

[4] Which put it below the European and American figures (19.5% and 20.7%, respectively) – whereas industrialised countries need less investment than developing countries - and certainly well behind the rate for Asia and Oceania (25.3%).

[5] UNCTAD, *Capital Flows and Growth in Africa*. Geneva: United Nations, 2000.

[6] World Bank, *World Bank Development Indicators*, Washington DC: The World Bank, CDROM edition, 2005.

[7] http://www.mines.gc.ca/VII/VII_A_i-fr.asp

[8] http://www.nepad.org/2005/fr/documents/inbrief.pdf

[9] United Nations, Report of the International Conference on Financing for Development, Monterrey, Mexico, 18-22 March 2002: http://www.un.org/esa/ffd/indexOverview.htm

[10] http://www.g8.gc.ca/2002kananaskis/kananaskis/afraction-en.asp

[11] c.f. G8 GLENEAGLES COMMUNIQUE – http://www.data.org/archives/000736.php

[12] The World Bank, *Prospects for the Global Economy*, May 30, 2006.

[13] http://devdata.worldbank.org/wdi2006/contents/Section4.htm

[14] Between 1989 and 2006, the number of African countries practicing multiparty politics increased from 4 to 26: c.f. http://ipsinternational.org/fr/_note.asp?idnews=3546

[15] Human Security Center, The Human Security Report, *War and Peace in the 21st Century*, 2005. Cf. http://www.humansecurityreport.info/index.php?option=content&task=view&id=127

[16] 85% of reforms in economic regulations actually take place within the first fifteen months following a political change. A change of power between political parties also appears to be the main "trigger" for reform, ahead of crises, international agreements, new diagnoses or donor pressure: c.f. World Bank/IFC, *Doing Business 2007: How to reform.*

[17] 67% of African countries implemented at least one reform in 2005-06, compared to just 35% of East Asian countries and 25% of South Asian countries: c.f. Nigel Twose, International Finance Corporation, *Improving the Investment Climate in sub-Saharan Africa*, NEPAD – OECD Conference, Brazzaville, 12th December, 2006.

[18]http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/AFRICAEXT/0, contentMDK:21043365~menuPK:258657~pagePK:2865106~piPK:2865128~theSitePK: 258644,00.html

[19] Standard and Poor's, UNPD, *The rating of sovereign states in Africa*, April 2006.

[20] The World Bank, *Meeting the Challenge of Africa's Development: A World Bank Group Action Plan*, 2005. Cf. http://siteresources.worldbank.org/INTAFRICA/Resources/aap_final.pdf

[21] China has thereby become the continent's third most important trading partner, after the United States and France: c.f. ECOWAS-SWAC/OECD, Atlas on Regional integration, Economy Series, *Africa and China*, December 2006

[22] http://allafrica.com/stories/200702051201.html. At the last China-Africa summit, the African countries and China were even planning to increase this figure to more than US$ 100 billion by 2010: c.f. http://www.jeuneafrique.com/articleImp.asp?art_cle=XIN00546levolnesral0

[23] World Bank, Global Development Finance, 2006.

[24] For example, it is estimated that in Uganda informal remittances are five times higher than official transfers: c.f. Africa Partnership Forum, *Resources for Development in Africa*, APF/MOS-2006/15.

[25] The capitalisation of African stock markets is increasing, not only in South Africa and the North African countries but in a certain number of middle-income SSA countries or countries with access to a large market, such as Namibia, Botswana, Kenya, Ghana, Nigeria etc. In addition, certain African firms and banks from countries other than South Africa are beginning to raise funds on the international capital markets, demonstrating the trust that international investors are placing both in these banks and firms, which have achieved a sufficient critical mass, and in the markets in which they operate (Cf. note no. 61).

[26] Under the impact of the new commitments made by the G8 countries, who at Gleneagles arranged to increase aid to Africa from US$ 25 to US$ 50 billion between 2005 and 2010, and of the active role played by "new" donors, particularly China, but also India and the countries of East Asia and the Persian Gulf. Since 2000, China alone has signed total or partial debt cancellation agreements amounting to US$ 10 billion and has undertaken to grant Africa concessionary loans worth US$ 10 billion over the period 2006-2008: c.f. ECOWAS-SWAC/OECD, 2006, *Ibid.*

[27] 20 African countries now have access to bank loans.

[28] Domestic revenues have increased by about 4% of GDP since the beginning of the new millennium and reached an average of 25.1% for all the SSA countries in 2005: c.f. IMF, Regional Economic Prospects – sub-Saharan Africa (2006).

[29] C.f. Africa Partnership Forum, *Resources for Development in Africa*, Moscow, 2006 (APF/MOS-2006/15).

[30] UNCTAD, World Investment Report, *FDI from Developing and transition economies: Implications for development*, Geneva, 2006.

[31] C.f. Stephen Thomsen, Chatham House, *Foreign direct investment in Africa: the private-sector response to improved governance*, International Economics Programme Briefing Paper, July 2005.

[32] Stephen Thomsen, *Ibid.*

[33] Economic Commission for Africa (ECA), *Economic report on Africa*, Addis Ababa, 2006.

[34] World bank, *Global Development Finance* 2005. Washington, DC: The World Bank, CDROM edition.

[35] http://www.unctad.org/Templates/Webflyer.asp?docID=6446&intItemID=2068

[36] Cf. OECD Development Center*, African Economic Outlook 2006, A Two-speed Continent?* Policy Insights n° 22, May 2006.

[37] Cf. The World Bank, 2007, *Challenges of African Growth, Opportunities, Constraints and Strategic directions*.

[38] See, *inter alia*: Morisset, J, "Foreign Direct Investment in Africa: Policies Also Matter." *Transnational Corporations* 9(2), 107-125, 2000.

[39] UNCTAD: *Capital Flows and Growth in Africa*, Geneva: United Nations, 2000.

[40] Cf. UNECA, *Economic report on Africa*, 2006. See also: World Bank, "Doing Business. Benchmarking Business Regulation", 2006. www.doingbusiness.org.

[41] Report of the Commission for Africa: *"Our common interest"*, March 2005 - www.commissionforafrica.org.

[42] C.f. Boyce, J.K. and L. Ndikumana: "Is Africa a net creditor?" New Estimates of Capital Flight from Severely Indebted sub-Saharan African Countries, 1970-1996", *Journal of Development Studies*, 38(2)L pp.27-56, 2001. The authors have

shown that the stock of flight capital over the period 1970-1996 amounted to US$ 285 billion, while the debt of those countries was no more than US$ 193 billion.

[43] Cf. The World Bank, *Challenges of African Growth, Ibid*, 2007.

[44] Yet real savings are not limited to visible savings and several studies have demonstrated that many households were saving much more than one might have supposed from official figures. In fact, the same factors that explain the weakness of the official savings rate (high level of inflation, difficulties of access to the banking network, political uncertainties etc.) also explain the volume of savings held in the form of physical capital (as livestock, land or real estate). This is at it may be, but the non-monetarisation of savings constitutes a major challenge as, looking beyond approaches based strictly on accountancy, it highlights the potential for developing domestic resources: c.f. SWAC/OECD-MDP, *Le financement du développement local – Un état des lieux en Afrique de l'Ouest* ["*The financing of local development – An inventory on West Africa"*], SAH/D(2002)532, January 2002.

[45] UNECA, 2006, *Ibid*.

[46] UNCTAD: Capital Flows and Growth in Africa, Geneva: United Nations, 2000.

[47] Just 25% of Africans have access to electricity, 36% to drainage and 64% to water; just 19% of African roads are asphalted and there are 8.9 telephone lines per 100 inhabitants.

[48] The World Bank, *Challenges of African Growth, Opportunities, Constraints and Strategic Directions, ibid p.64, 2007.*

[49] The World Bank, *Challenges of African Growth, Opportunities, Constraints and Strategic Directions, ibid p.61, 2007.*

[50] The World Bank puts them at almost US$ 40 billion of investment per annum for the next 10 years, if they are to achieve the MDGs.

[51] Presentation by Michael Roeskau (OECD), at NEPAD-OECD Roundtable on investment in Africa, held in Brazzaville, 12th-13th December 2006.

[52] C.f. Michel Wormser (World Bank), *Accelerating support to infrastructure in Africa*, Infrastructure Consortium Meeting, Berlin, January 2007.

[53] Ndikumana, L. and J. Nannyonjo: "From Failed State to Success Story?" in J.K. Boyce (Ed.), *Peace and the Public Purse* (forthcoming), 2006.

[54] World Bank/IFC, *Doing Business 2007: How to reform*.

[55] http://allafrica.com/stories/200702051201.html

[56] Aside from regulation per se, programmes designed to reinforce such interaction could also be set up. For example, Egypt has established a programme to reinforce the capacity of domestic suppliers, whereby the 100 leading transnational firms trading in the country designate twenty local subcontractors who are to benefit from technical assistance and an expanded credit programme: c.f. UNCTAD, World Investment Report 2006, *FDI from Developing and Transitions Economies: Implications for Development*, Geneva, box II.3.

[57] Publish what you pay/Revenue Watch Institute, Eye on EITI, *Civil Society Perspectives and Recommendations on the EITI*, Oct. 2006.

[58] It would be interesting to assess the progress made in implementing the Washington Agreement of 2004, reaffirmed in St. Petersburg in 2006.

[59] C.f., in particular, the dialogue conducted in the context of the IFC (International Finance Corporation).

[60] A growth in capital inflows is all the more likely to cause an appreciation of the exchange rate and inflationary surges if the financial system is tight. Thus, the ratio of money supply to GNP (M3/GNP), which expresses the financial depth or degree of monetarisation of an economy, is 25.4% for sub-Saharan Africa, compared to 105.6% in the developed economies and 150.6% for East Asia and the Pacific. Indeed, the development of capital markets could increase the financial depth of African economies.

[61] Furthermore, certain African firms and banks are already accessing not only regional markets, but also international capital markets in order to refinance themselves. For example, one Nigerian bank recently successfully took out Eurobonds worth US$ 521 million in a single day, 221 more than it had hoped to raise when it launched the operation: c.f. http://timbuktuchronicles.blogspot.com//2007/01/gtbanks-eurobond-issueover-subscribed.html

[62] Certain countries that developed their stock markets at an early stage, such as South Africa, Egypt, Morocco and Tunisia, thereby feature among the ten leading recipients of FDI on the continent.

[63] The ASEAN (ASEAN +3) governments have launched an initiative guaranteeing certain investments on the Asian bond market (Asian Bond Market Initiative) so as to limit exchange rate fluctuations and to develop the local market.

[64] For example, the *Agence française de développement* [“French Development Agency”; AFD] is providing guarantees to banks from the priority solidarity zone for French cooperation that grant loans to SMEs, so as to limit the risks incurred by those banks: c.f. AFD and the Private and Financial Sectors, *Financing Sustainable Development.*

[65] Thus, Syngenta, a foundation including public and private banks (including Deutsche Bank and Shell) has created a US$ 43 million facility designed to finance loans to agriculture of between US$ 50,000 and 1 million in Uganda, Tanzania, Kenya (relying to this end upon the regional market created by these three countries) and Rwanda: c.f. http://www.syngentafoundation.org/syngenta_foundation_organization.htm.

Africa Partnership Forum

8th Meeting of the Africa Partnership Forum
Berlin, Germany
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Expert Meeting on Investment

23 February 2007 ◆ Johannesburg, South Africa

A meeting of African and international experts was organised jointly by the APF Support Unit and the NEPAD Secretariat in Johannesburg on 23 February 2007, as part of the process of developing this paper. We are grateful for the comments and advice received at this meeting. The full list of institutions represented is below.

INTERNATIONAL AND AFRICAN INSTITUTIONS
African Development Bank (AfDB)
Food and Agriculture Organization (FAO)
Infrastructure Consortium for Africa (ICA)
International Finance Corporation (IFC)
Organisation for Economic Co-operation and Development (OECD)
United Nations Conference on Trade and Development (UNCTAD)
United Nations Economic Commission for Africa (UNECA)
United Nations Industrial Development Organization (UNIDO)
OTHER INSTITUTIONS
Investment Climate Facility (ICF)
South African Institute of International Affairs (SAII)
GOVERNMENTS
Republic of Congo
Denmark
Germany