FOCUS ISSUE 2: INVESTMENT

WHAT COMMITMENTS AND TARGETS HAVE BEEN AGREED?

Africa:

- The NEPAD founding statement of 2001 clearly identified the need to increase private capital flows to Africa, as an essential component of a sustainable long-term approach to filling the resource gap. It identified priorities including addressing risk perception, building public-private partnerships, and deepening capital markets. Successive statements by African governments have reinforced these priorities;

- The African Peer Review Mechanism includes 'increased trade and investment among the participating countries' and 'increased co-operation in mobilising and attracting both domestic and foreign investment' among its 'high priority areas'.

International Community:

- At Monterrey in March 2002, developed and developing countries committed themselves to redouble their efforts to help unblock and make more efficient use of the resources necessary to drive development, notably domestic and foreign private investment, particularly through the improvement of the business climate;

- Within this framework, development partners have committed themselves, including at successive G8 summits from Kananaskis in 2002 onwards, to helping Africa attract investment both from within Africa and abroad, including by supporting African initiatives aimed at improving the investment climate and fostering efficient and sustainable regional financial markets, and by enhancing international cooperation to promote greater private investment and growth in Africa including through public-private partnerships.

WHAT HAS BEEN DONE TO DELIVER ON THESE COMMITMENTS?

Africa:

- Africa has taken major steps to improve its business environment: the macro-economic environment has become more stable, and progress is being made in reforming economic regulations. Real progress has been made in reducing the complexity and cost of regulation, improving transparency and tackling corruption. Africa was the third-fastest region in terms of reforming its economic regulations in 2005. Three African countries feature among the top 10 reformers for 2006/07 in the World Bank's latest 'Doing Business' survey. Even so, the costs of doing business still remain significantly higher than in other regions.

International Community:

- To support African partners in these efforts, the international community has focused on a variety of measures including micro-finance, assistance for institutions for private sector development, and support for structural reforms aimed at improving the business environment. Specific initiatives to address the investment climate include the Enhanced Private Sector Assistance (EPSA) for Africa, the Foreign Investment Advisory Service of the International Finance Corporation, the NEPAD/OECD Africa Investment Initiative, and the Investment Climate Facility. More broadly, the international community has also stepped up its support for infrastructure, which is also key to attracting more investment, in particular through the Infrastructure Consortium for Africa.

WHAT HAVE THE RESULTS BEEN?

- The picture is nonetheless mixed. Net private capital flows to Africa rose from US$ 13 billion in 2002 to over US$ 60 billion in 2006 (North Africa: US$ 3 billion to US$ 26 billion; sub-Saharan Africa: US$ 10 billion to US$ 36 billion). Within this overall total FDI accounted for US$ 35.5 billion (North Africa US$ 19.8 billion and sub-Saharan Africa US$ 15.7 billion). Investment is set to reach close to 22% of GDP, an all-time high for the region. It is particularly strong in the low and middle-income country groups. Significant new investors are now engaging in Africa, from within and outside the continent – indeed one of the central challenges is how to increase domestic and intra-regional investment by keeping more wealth and savings in Africa, as well as increasing the level of foreign investment. New mechanisms are being developed to boost intra-African investment. The newly created private equity fund, the Pan-African Infrastructure Development Fund (PAIDF), to be managed by the AfDB, is an initiative to tap resources from potential shareholders including public and private pension funds and asset management firms;

- At the same time, the investment ratio is still significantly below the average figure for East Asia (38%) and South Asia (31%). Increasing the investment ratio would clearly help to increase and sustain economic growth. In addition to the investment gap, there is also in a number of slower-growth countries a productivity gap: the return to investment in high-growth countries is at levels comparable to Vietnam, but in slower-growth countries it is significantly below this – pointing to the need in these countries to increase both investment levels and efficiency;

- Despite the importance placed by African governments on the deepening of financial markets, progress in this area, and in building financial sector capacity and improving the management of financial institutions, remains uneven. Moreover the inadequacy of infrastructure and services continues to act as a disincentive for investors, as well as a constraint on economic growth, and human and social development.

WHAT ARE THE KEY PRIORITIES?

Action by Africa:

- Continued action to improve the investment climate, mainly through simplifying and modernising economic regulations, and the reduction of risks and uncertainties affecting investor perceptions;

- Further action to deepen financial markets by improving the efficiency and reach of the banking sector, developing domestic debt and equity markets to mobilise domestic savings, and expanding micro-finance activities;

- Continued emphasis on the improvement of infrastructure, as a key to improving the competitiveness of African enterprises, and hence their attractiveness to investors.

Response by the international community:

- Further support for African efforts to improve the investment climate, including through assistance to legal, regulatory and administrative reforms and measures to facilitate competition, and the accelerated implementation of new mechanisms such as the Investment Climate Facility;

- More support for African efforts to deepen financial markets by improving the management of financial institutions, developing new financial products including insurance and guarantee schemes, and increasing access to financial services;

- Continue the recent trend of increased support for the development of infrastructure (see also Focus Issue 4 in Part II on sectoral priorities).

I. Successes, bottlenecks, critical next steps and responsibilities

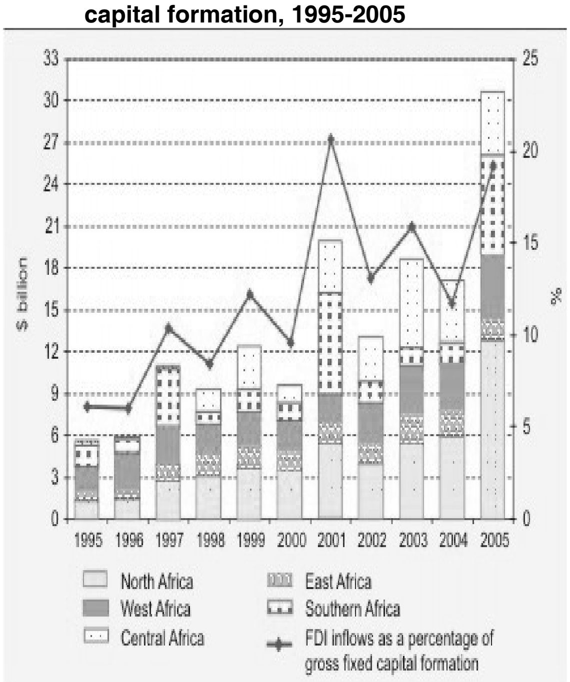
Key issues	Successes	Bottlenecks	Critical next steps	Responsibilities
Improving economic governance	There has been a spectacular recovery in growth and macro-economic stability since 2000	Institutional capacity	Reinforce institutions and the application of economic regulations, particularly the legal system and the implementation of contracts, and regulation of financial markets	African states with support from development partners
	Significant work has been undertaken to reform economic regulations	But these remain complex and cumbersome	Simplify economic regulations, including registration, employment legislation and company law	African states and development partners
	Serious attempts to combat corruption are being implemented	But more needs to be done	Accelerate the roll out and implementation of instruments to combat corruption, both in Africa and internationally	Private sector, African states and international community
Reinforcing financial markets	Financial markets are more stable following reforms; Central Banks are more actively involved in oversight; banks following international standards (Basel II)	Lack of long-term resources for private investment ; risk aversion by banking sector to enterprise financing	Support African efforts to strengthen financial market intermediation; scale up resources to build financial sector capacity in Africa; improve management of financial institutions	African states and development partners
	Public-private partnerships and agreements between commercial banks and development banks are creating new financial instruments and guarantee arrangements to fill credit market gaps	Few lending and savings instruments are suited to the financial needs of SMEs and agro-businesses	Develop risk-reduction instruments and techniques and promote their use; strengthen private sector capacity to develop feasibility studies for investment projects	Development finance institutions, private banks
	African capital markets are growing, not only in North Africa and South Africa, but also in a number of other countries	Capital markets are thin and illiquid; inadequate stock and debt market oversight and regulations; limited efforts to integrate stock markets at the regional level	Provide incentives for pension funds and other institutional investors to participate more actively in the local capital market; reinforce capital market oversight and regulations; facilitate cross-listing of shares	African states, RECS and development partners
	An increased number of micro-finance initiatives of benefit to women, the poor and the rural sector	Poor insitutitonal capacity among microfinance institutions; need for longer term lending instruments; microentrepreneurs lack necessary skill base to grow and develop	Reinforce capacity of micro-finance institutions , provide training in business management practices and product development to micro-enterprises	African states and development partners, civil society, private sector

Key issues	Successes	Bottlenecks	Critical next steps	Responsibilities
Developing national and cross-border infrastructure	Development partners and emerging financiers such as China, India and Arab partners are increasing their funding of infrastructure	Large investment gaps remain in all sectors. The co-ordination of resources and upstream project preparation efforts continue to be weak/inadequate	Sustain recent trend of increasing investment in infrastructure including regional projects Ensure adequate resources for upstream project preparation	Development partners / African states
	The Infrastructure Consortium for Africa is playing a positive role as a framework to co-ordinate and facilitate the delivery of additional resources.	Many countries still lack national infrastructure development frameworks	Countries to prepare strategic frameworks where not yet available	African states
	Private-sector participation and investment have gone beyond telecommunications to include power generation, railways, ports and airport services.	Private participation in the infrastructure sector is still limited and concentrated in i) a handful of countries (South Africa and North Africa, in particular) and ii) in telecommunications and, to a lesser extent, the energy sector	Use guarantee mechanisms such as partial risk guarantees and political risk insurance to increase private sector involvement (Investment Climate Facility for Africa, Public-Private Infrastructure Advisory Facility)	African states, Development partners and private sector
	Funding for regional projects has risen sharply in recent years.	Funding for regional projects by multilateral agencies reaching a plateau. Intervention by bilateral development partners still limited Regional projects still face numerous obstacles such as the lack of harmonisation of the legal framework or inadequate delegation of decision-making	Speed up economic and legal integration at the regional level; strengthen REC capacity and authority to co-ordinate regional projects	African states, RECs and Development partners

Key issues	Successes	Bottlenecks	Critical next steps	Responsibilities
Developing human capital	Many vocational training and apprenticeship programmes are being initiated	Lack of sufficient vocational training and certification	Develop the “continuing” (particularly ”non-formal”) vocational training of young people and workers, and integrate it within national education programmes to improve standards	African states and development partners
	Increasing numbers of African executives are being trained in Africa or abroad	Brain drain of qualified staff to other countries; inability to attract skilled diaspora	Strengthen policies and develop incentives to encourage engagement of diaspora in economic activities in Africa; improve managerial standards and increase business school partnerships	African states, private sector
	Workforce more skilled as a result of progress towards universal education	Quality of education does not necessarily match the progress achieved in school attendance rates	Recruit more teachers, improve teacher training and skill level	African states, development partners

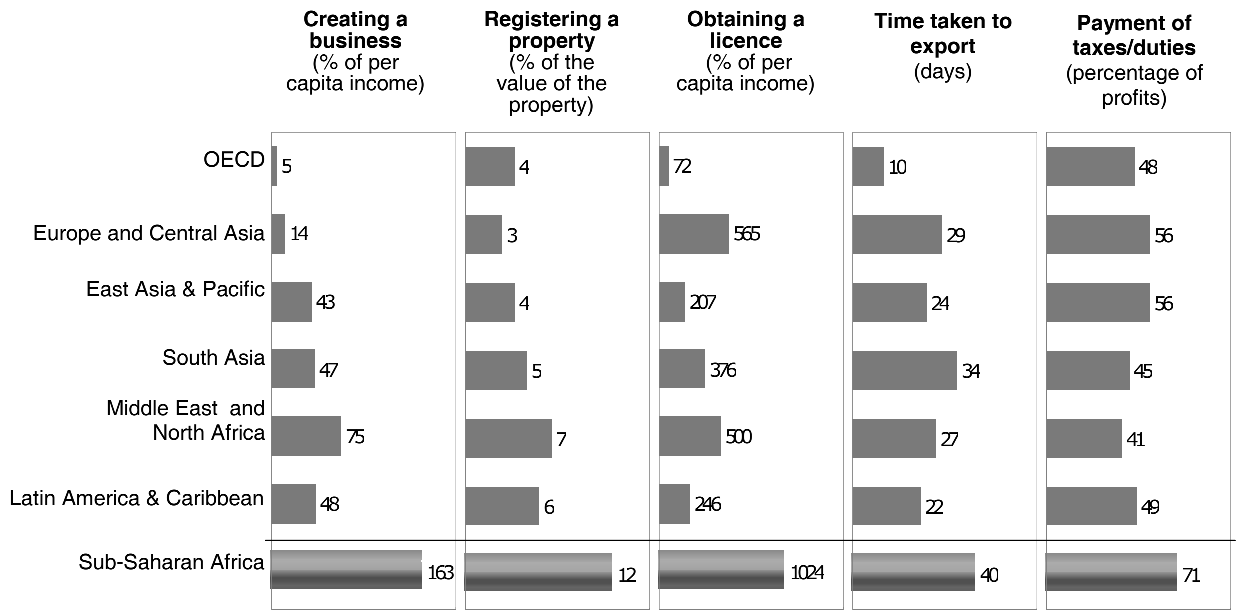
II. Investment: Results

Africa: FDI inflows and their share in gross fixed capital formation, 1995-2005



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex tables B.1 and B.3.

The highest cost of doing business in the world



Source: World Bank, Doing Business Report (2005/06)

ANNEX: Key Monitoring Issues

1. Improving economic governance

Indicators	Evaluation
1. Institutional capacity	African countries have made major steps forward in the areas of macro-economic management, and public financial management and accountability. More countries are running smaller deficits, meeting their targets for revenue mobilisation, managing their tax systems more effectively, improving fiscal transparency, and creating institutions and arrangements for better auditing of public funds. Many countries have also taken important steps to encourage private investment, including removing administrative barriers to the registration of private firms, protecting property rights, providing land for sitting industries, and improving infrastructure and security. Good economic governance also requires strong institutions. Important actions have been taken in the area of legal and judicial reform, and the strengthening of legislatures and judiciaries to enhance their effectiveness and independence. At the same time, sub-Saharan Africa continues to score lower than other regions in 3 indicators of institutional quality: rule of law, regulatory quality, and corruption (World Bank[1]). It is widely recognised that institutional capacity remains a major constraint, and a key to improving economic governance. The UNECA African Governance Report of 2005 identifies a number of specific priorities including deepening of legal and judicial reforms, and removing bottlenecks to private investment. In particular, it identifies the need for consistent policies and regulations governing the establishment and operation of businesses, the protection of property rights and the enforcement of contracts, programmes to enhance business development and technical support services, and the provision of good information on markets and investment opportunities.
2. Quality of economic regulations	Africa is the region of the world that has undertaken the third greatest amount of reform of its economic regulations in 2005/2006 (67% of African countries implemented at least one reform, compared to just 35% of East Asian countries and 25% from South Asia), while Egypt, Ghana and Kenya feature among the ten leading reformers in 2006/2007 (International Finance Corporation, *Doing Business 2008*);[2] Ghana cut bottlenecks in property registration, reducing delays from six months to one; Kenya's licensing reform program has eliminated 110 business licenses; Mauritius has reduced the property registration fee to 5% of the property value; Burkina Faso introduced a one-stop shop for company registration which cut the time for business start up to 18 days; Mozambique replaced legislation dating from 1888 with a new commercial code that introduces stricter corporate governance rules (International Finance Corporation, *Doing Business 2008*); In 2006, Nigeria became the 110th state rated by Standard and Poor's and the 14th in Africa; progress achieved led to improved ratings for Egypt, South Africa and Morocco;[3] However, due to the poor quality of its regulations, Africa remains the continent where it costs the most – and where it takes the longest amount of time to carry out business activities (C.f. Section II: *"The highest cost of doing business in the world"*); The G8 has pledged support for national and regional efforts "to improve the investment climate by means of regulatory and administrative reform (including the implementation of national APRM recommendations)";[4] Africa is also the developing region where labour market rigidities remain the greatest (World Bank).[5]

3. Transparency and combating corruption	The 2007 Corruption Perceptions Index (CPI) results show that “Africa is producing good results in the fight against corruption”. Across Africa, countries including Namibia, Seychelles, South Africa and Swaziland scored significantly higher (Transparency International) than the previous year;[6] Nigeria is the only one of the fifteen African signatories of the Extractive Industries Transparency Initiative (EITI) to have fulfilled all its commitments under the initiative, notably the publication of audited, reconciled reports;[7] The African Union Convention on Combating and Preventing Corruption, adopted on 11 July 2003, has been signed by 26 of the 53 AU member states, but has only been ratified by 11 members;[8] The United Nations Convention against Corruption has yet not been ratified by several OECD countries.[9] There are also important 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 Convetion, 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.

2. Reinforcing financial markets

Indicators	Evaluation
1. Overcoming market failures to address the financial needs of SMEs and agro-businesses ("finance for growth")	SMEs are still experiencing major problems in gaining access to finance, due in particular to the strong risk aversion of banking institutions. Financial systems in most African countries are dominated by a small number of banks that dominate the market.[10] Demanding guarantee requirements and formalities are still required, interest rates are high (twice as high as 1980s levels in some countries[11]) and financial products on offer are limited (UNECA); With a few exceptions (northern and southern Africa, and – to a lesser extent – East Africa), African agriculture remains seriously under-funded (particularly the crop sector), which to a large extent explains its chronic under-capitalisation. An analysis of agricultural capital stock in the 1990s showed that in Africa it was at a sixth of Asian levels and a quarter of levels seen in Latin America.[12] Rural credit institutions that were dismantled during the structural adjustment era are taking a significant amount of time to re-establish themselves; New initiatives (foundations promoting public-private partnerships in finance, development banks lending to commercial banks at concessional rates or guaranteeing their loans to SMEs and farmers) are being developed with the aim of filling the gap of intermediate financial products and finance for agriculture: There is still a need to reinforce competition policies and increase the flexibility of guarantees (particularly property titling) in the banking sector.
2. Development of capital markets	Despite widespread development and high levels of profitability, African capital markets are still marked by their inadequate size and by large regional disparities (the differences are enormous between South Africa, whose stock market capitalisation is comparable to that of the industrialised countries or the nations of North Africaand the rest of Africa). Refinancing difficulties feature as one of the main reasons put forward by multinationals to justify their comparatively ow level of investment in Africa (UNCTAD)[13]; G8 countries are committed to "developing long-term local currency financing and suitable insurance instruments for coverage of exchange rate risks."
3. Availability of micro-finance for women, the poor, micro-entrepreneurs and craft workers from the informal sector ("finance for all")	Despite spectacular development, African micro-finance is still concentrated in a limited range of sectors and activities (urban communities, womens' groups and mutual assistance associations, purchasing groups, consumer credit, commercial intermediation etc). This explains the lack of diversification of available products and the small sums involved. The rural world and productive activities, particularly processing, still receive insufficient support – this is even more true for urban and rural micro-entrepreneurs; The G8 is planning to develop a regional Micro, Small and Medium Enterprises Investment Fund (REGMIFA) as "an instrument to mobilize resources to refinance medium- and long-term investment credits for smaller enterprises and to microfinance institutions." G8 leaders also committed themselves to strengthen microfinance institutions' capacities through training programmes and technical assistance.

3. Developing infrastructure

Indicators	Evaluation
1. Increased and rationalised infrastructure expenditure (ODA and government expenditure)	Government expenditure on infrastructure has begun to increase again after a long period of decline. This is particularly true of: • the oil-producing countries (Algeria, Nigeria, Angola etc.); • the countries of North Africa; • countries whose efforts to achieve budgetary discipline have allowed them to follow expansionist policies (South Africa) etc.; Second-generation road funds financed by duties on petroleum products and other revenues and managed by a board of directors comprising road users' representatives have been set up in 26 countries in sub-Saharan Africa. Thirteen of these road funds obtain 90% of their income from fees on users (principally duties on petroleum products). However, no more than about a third of them are deemed to be adequately meeting standard maintenance requirements; ODA devoted to infrastructure turned upwards again from 2003 onward, after experiencing a continuous decline since 1985;[14] Not only has external support for African infrastructure been increasing significantly for several years, hitting US$ 7.5 billion in 2006 (ICA)[15], but it is also better co-ordinated thanks to the creation of the Infrastructure Consortium for Africa; However, those countries in sub-Saharan Africa that are not oil-producers continue to be under-resourced for developing infrastructure necessary for their development; Africa needs almost US$ 40 billion of investment in infrastructure per annum for the next 10 years (World Bank).
2. Involvement of the private sector in financing infrastructure in Africa	Launch of the Investment Climate Facility for Africa – a public-private partnership with several objectives including infrastructure development – on 1st June 2006 / 1st project of the facility in 2007 / G8 support confirmed at the Heiligendamm Summit; Africa is the developing region in which private investment in infrastructure is growing the fastest – but this progress predominantly concerns telecommunications and, to a lesser extent, energy, whereas transport, water and sanitation remain very heavily dependent upon public funds (World Bank).[16]
3. Rationalisation of management and oversight to develop regional infrastructure	In September 2006 the African Union Commission (AUC), NEPAD Secretariat, RECs, African Development Bank (ADB) and AU Specialised Institutions agreed on principles for a co-ordination mechanism for infrastructure development; The G8 has decided to launch an initiative to strengthen the Regional Economic Communities' (RECs) capacities for the development of cross-border infrastructure.

4. Developing human capital

Indicators	Evaluation
1. Developing vocational training	*"Ensuring that the learning needs of all young people and adults are met through equitable access to appropriate learning and life skills programmes"* is one of the six Education for All (EFA) goals established at the 2000 World Education Forum in Dakar; Efforts made by African states tend to concentrate on universal primary education but do not pay enough attention to life skills training for youth and adults (2003 EFA monitoring report); More programmes for learners in non formal settings – such as "Starting my own small business" (UNESCO) which is intended to provide supplementary knowledge to young people receiving technical and vocational education and training – are being developed.[17]
2. Integration of qualified workers from the diaspora into working life	Since 1990, at least 20,000 people have left the African continent annually (International Organization of Migration), including numerous skilled workers. The UN Development Programmed (UNDP) notes that in Africa, the loss of medical doctors has been the most striking. To fill the gap created by the skills shortage, African countries spend an estimated US$ 4 billion annually to employ about 100,000 non-African expatriates (UNECA);[18] The African Union adopted a "Migration Policy Framework for Africa", which recommends creating "the necessary political, social and economic conditions such as an enabling policy environment, democracy and good governance to serve as incentive to attract Diaspora."[19]
3. Trend showing percentage of children enrolling in primary school	There has been progress towards universal primary education with enrollment increasing from 57% in 1999 to 70% in 2005 (UNESCO), but this rate is still significantly lower than in other developing regions (88%);[20] In addition, the greater number of children receiving an education has not systematically led to increased primary school completion rates: : just 55% of children from the continent were able to complete a full primary education in 2000, compared to 57% in 1990.

[1] Kaufmann D., A. Kraay, and M. Mastruzzi, 2005, Governance Matters IV: Governance Indicators for 1996-2004, http://econ.worldbank.org
[2] http://www.doingbusiness.org/
[3] Standard and Poor's, UNPD, *The rating of sovereign states in Africa*, April 2006
[4] www.g-8.de, G8 Heiligendamm Summit Declaration on Growth and Responsability in Africa, paragraph 28.
[5] World Bank, "Doing Business. Benchmarking Business Regulation", 2006.
[6] Transparency International, 2007 Corruption Perceptions Index, http://www.transparency.org/policy_research/surveys_indices/cpi/2007/faq#change2
[7] Publish what you pay/Revenue Watch Institute, Eye on EITI, *Civil Society Perspectives and Recommendations on the EITI*, Oct. 2006.
[8] http://www.mibs.gov.zm/index.php?option=com_content&task=view&id=140&Itemid=142
[9] http://www.unodc.org/unodc/crime_signatures_corruption.html
[10] Senbet, L.W. and I. Otchere, 2006. "Financial Sector reforms in Africa. Perspectives on Issues and Policies." In Bourguignon, F. and Boris Pleskovic, Eds., *Annual World Bank Conference on Development Economics – Growth and Integration.* Washington D.C.: The World Bank, 81-819.
[11] Economic Commission for Africa (ECA), Economic Report on Africa 2006, *Capital Flows and Development Financing in Africa*.
[12] http://www.fdimagazine.com/news/fullstory.php/aid/17/Going_long.html
[13] UNCTAD, Capital Flows and Growth in Africa, Geneva: United Nations, 2000.

[14] Presentation by Michael Roeskau (OECD), at NEPAD-OECD Roundtable on investment in Africa, held in Brazzaville, 12th-13th December 2006.
[15] Infrastructure Consortium for Africa, "Africa's Demand for Infrastructure", ICA Senior Level Meeting, January 17, 2007, Berlin, Germany.
[16] C.f. Michel Wormser (World Bank), *Accelerating support to infrastructure in Africa*, Infrastructure Consortium Meeting, Berlin, January 2007.
[17] http://portal.unesco.org/education/admin/ev.php?URL_ID=49258&URL_DO=DO_TOPIC&URL_SECTION=201&reload=1193044592
[18] http://www.un.org/ecosocdev/geninfo/afrec/vol17no2/172brain.htm
[19] African Union, Executive Council, 9th ordinary session, 25 – 29 June 2006, Banjul, THE GAMBIA, The Migration Policy Framework for Africa.
[20] United Nations, « Africa and the Millenium Development Goals », 2007 Update.