Investors start to eye Africa

Hurdles to productive foreign investment remain high

By **Ernest Harsch**

Usually, when investors look around for someplace to put their money, Africa is practically invisible. But at a time of uncertainty in global financial and capital markets — and with natural resources such as oil in high demand — a few are starting to give more than a passing glance in Africa's direction. In fact, inflows of foreign direct investment (FDI) to African countries increased in 2003 by 28 per cent from the year before, from $12 bn to $15 bn (see graph).

This put Africa in the uncustomary position of registering the highest growth rate for foreign investment of any region in the world, developing and developed alike, reports the UN Conference on Trade and Development (UNCTAD). The 2004 edition of the agency's annual *World Investment Report,* released in September, predicts that FDI flows to Africa will increase even further in 2004.

"The investment potential in Africa is huge," UN Under-Secretary-General and Special Adviser on Africa Ibrahim Gambari noted in October. "The rates of return on investment in Africa are possibly the highest in the world." However, both foreign and domestic investors face many obstacles in most African countries, he added, speaking to a meeting on the private sector and the New Partnership for Africa's Development (NEPAD), the continental development framework. "Supporting African countries' efforts to define and implement policies that can create an enabling environment for investment is therefore a top priority for the NEPAD initiative."

Though growing modestly, flows of foreign investment to Africa are still minuscule in relation to global FDI flows. In 2003, Africa's share was just 8.7 per cent of the $172 bn received by all developing countries combined.

NEPAD argues that Africa will need to raise more external financing for its ambitious development goals through a variety of means, including increased aid, deeper debt relief and expanded export revenues. But it also recognizes that foreign investment must make a greater contribution if the continent is to achieve economic growth rates high enough to reduce poverty.

According to UNCTAD, foreign investment is already a major source of outside financing for Africa. In 1990, FDI inflows were only around $2.5 bn, lagging far behind official development assistance and other official flows. But as aid disbursements declined steadily for most of that decade and as foreign investment grew modestly, the gap has disappeared. In 2002, FDI inflows accounted for 46 per cent of Africa's total external resource receipts. Taking the annual average over 2000-02, they even exceeded average official net resource flows.

Rise in clothing industry . . .

The geographic distribution of FDI inflows within Africa was more "broad-based" in 2003 than in any other year this decade, UNCTAD also reports. Several small African economies, including in least developed countries, shared in the growth in foreign investment.

One reason is that more African countries are benefiting from the US's Africa Growth and Opportunity Act (AGOA), which provides duty-free access to US markets for apparel and other products manufactured in eligible African countries. In addition to foreign investments in a large clothing factory in Namibia, set up in 2001, new investments have flowed into garment manufacturing in Swaziland, Mozambique and Mauritius. "The biggest winner was Lesotho," notes the report. Lesotho became the largest African apparel exporter to the US in 2003, with about 10,000 new jobs created that year.

In 2004, the US Congress approved the extension of the overall AGOA programme until 2015. That makes it more likely, UNCTAD says, for foreign investors to expand their involvement in African countries and industries able to take advantage of the act.

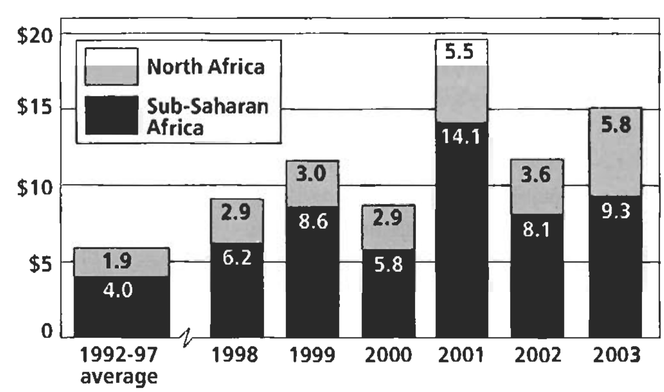
. . . but oil remains the top prize

Nevertheless, FDI flows to Africa are still skewed overwhelmingly towards extractive industries, especially oil. The bulk of the increase in flows in 2003 was accounted for by oil exploration and extraction, especially in Algeria, Angola, Chad, Equatorial Guinea, Libya, Nigeria and Sudan. Out of the top 10 recipients of FDI inflows in 2002 and 2003, seven were oil producers.

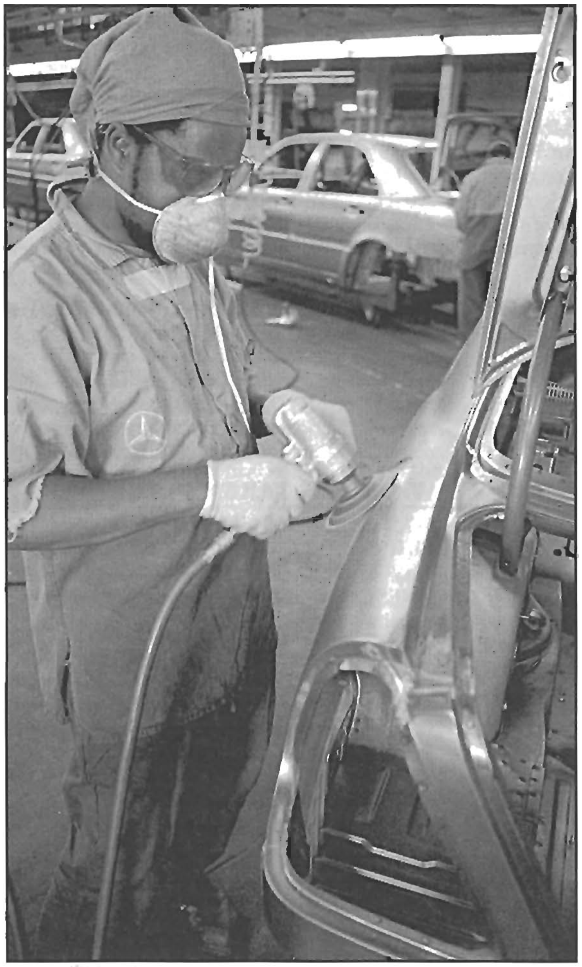
Algeria has succeeded in beginning to diversify its investment flows into sectors other than oil, including steel, chemicals, pharmaceuticals and telecommunications. But few other sectors in most African oil producers have been able to attract serious investor interest. Since oil, mining and other extractive activities generally do little to stimulate production in other parts of the economy, such investments have only limited development benefits.

As African countries seek to draw investors into productive sectors such as manufacturing and agriculture, UNCTAD argues, they will need to further reform their investment codes and stream-

Foreign direct investment flows, $ bn



Source: UN Africa Renewal from UNCTAD data.



Africa Photos / Eric Miller

Mercedes-Benz auto factory in South Africa. For many other African countries, it is difficult to attract foreign investment into manufacturing activities, leaving oil and mining dominant.

line cumbersome bureaucratic procedures for approving new investment projects.

Towards that end, UNCTAD has worked with nearly a dozen African countries to develop "investment policy reviews" that identify investor concerns, highlight priority reforms and seek to expand the linkages between investment and national development goals.

The reviews for Ghana, Lesotho and Uganda, for example, emphasize the importance of attracting new investments in light manufacturing and agro-industrial industries, while Mauritius, which has already been successful in those areas, is now turning its attention to high-value financial services. Ethiopia is looking to ensure that local enterprises can take advantage of foreign investment projects, either as suppliers or partners. Botswana, long a relatively attractive outlet for foreign investors, is now contemplating restricting FDI in a number of industries in order to provide better opportunities for domestic private businesses.

Red tape and governance

Excessive bureaucracy and poor governance also remain problems. Between 2001 and 2003, the World Bank conducted "investment climate" surveys of more than 3,000 companies in eight African countries. As cited in the Bank's *World Development Report 2005,* released in September, the surveys found that corruption is a top constraint. In Kenya, more than 75 per cent of firms reported that they had to pay bribes, while 70 per cent of companies in Zambia complained that regulations have been interpreted in unpredictable ways. About half of all firms surveyed did not have confidence that their national court systems would uphold their property rights.

"It is clear," notes Mr. Serigne Mbacké Sougou, a Senegalese tax inspector, "that if judicial rules can change at any time, if state governance operates on the principle of the abuse of power or if court decisions are slow or irrelevant, then FDI will not be attracted to a country. If corruption comes on top of all that, then foreign investment will turn towards other horizons."

Senegal is generally considered a good prospect by French investors, Mr. Jean-Louis Castelnau, vice-president of the French Council of Investors in Africa, remarked during a visit to that country in October. But even there, he complained, "decisions about investment always take a long time."

From AIDS to infrastructure

Foreign investors also cite Africa's broader problems as deterrents. "There is a perception that many countries in Africa are in conflict, and security issues prevent companies from going over there," observes Mr. Satoshi Tsuzukibashi, the Latin America, Middle East and Africa manager for the Japan Business Council (known as Keidanren). For example, during Algeria's civil war in the 1990s, all Japanese companies pulled out, Mr. Tsuzukibashi told *Africa Renewal* at his Tokyo office. "Now the situation has calmed down and the companies are going back."

AIDS is also a major problem for Japanese investors, says Mr. Tsuzukibashi. "Japanese companies have the concern that if they build their factories, the workers may not be around very long." In addition, educational levels are generally low in Africa, making it hard to find skilled workers. Finally, he concludes, basic physical infrastructure is often lacking or of poor quality, raising the costs of production. "Without the infrastructure and the development of markets, it is unlikely that investment will increase."

Mr. Wiseman Nkuhlu, head of the NEPAD Secretariat, also believes that investing in infrastructure is vital. "Yes, governance and corruption do matter, but they are not the only reason for the low rate of investments in Africa," he told a September 2004 business conference in Cape Town, South Africa. "The other reason is the cost of doing business in Africa. It is just too high, because of the lack of access to basic services and poor connectivity — hence the NEPAD focus on infrastructure."

The World Bank report adds that since private investment in roads, railways and other infrastructure is often quite limited, governments should step in to address such shortcomings. "Public investment in infrastructure can improve the investment climate," the Bank points out.

Business experts are increasingly coming to believe that improving Africa's prospects for private investment will entail more than simply liberalizing economies and reforming investment codes. It will also require developing strong and capable states that can ensure peace and stability, invest in areas that stimulate productive activity, raise the education and skills of Africa's work force and combat AIDS and other debilitating health problems. ■