58 113

BACKGROUND PAPER NO.3

UNITED NATIONS

ECONOMIC AND SOCIAL COUNCIL

ECONOMIC COMMISSION FOR AFRICA

Ad-hoc Expert Group Meeting on the
Revitalization of Investment for Africa's
Development: Prospects in the 1990s and Beyond

Addis Ababa, 29 November - 1 December 1993

THE FALL OF INVESTMENT IN AFRICA IN RECENT YEARS

(Culled from World Economic Survey, UN, N.Y., 1993, pp. II 41-45)

Recovery of investment is crucial to a long-term improvement in economic performance in Africa. Economic reform has not, however, brought a significant increase in investment. In some countries the investment ratio has marginally improved. However, in almost all African countries it remains far below its peak levels of the mid-1970s (see figure II.6). Several factors have contributed to this1/ First, profit or net income expectations have been low because of a generally weak economy and declining export commodity prices. Secondly, the poor and deteriorating state of infrastructure in many countries has driven up the costs of private investment. Present levels of public investment in many countries are insufficient to reverse this and are unlikely to increase significantly because of fiscal adjustment.2/ In countries such as Burkina Faso, Chad, Ghana and Guinea, public investment levels have increased or been maintained largely owing to external finance.

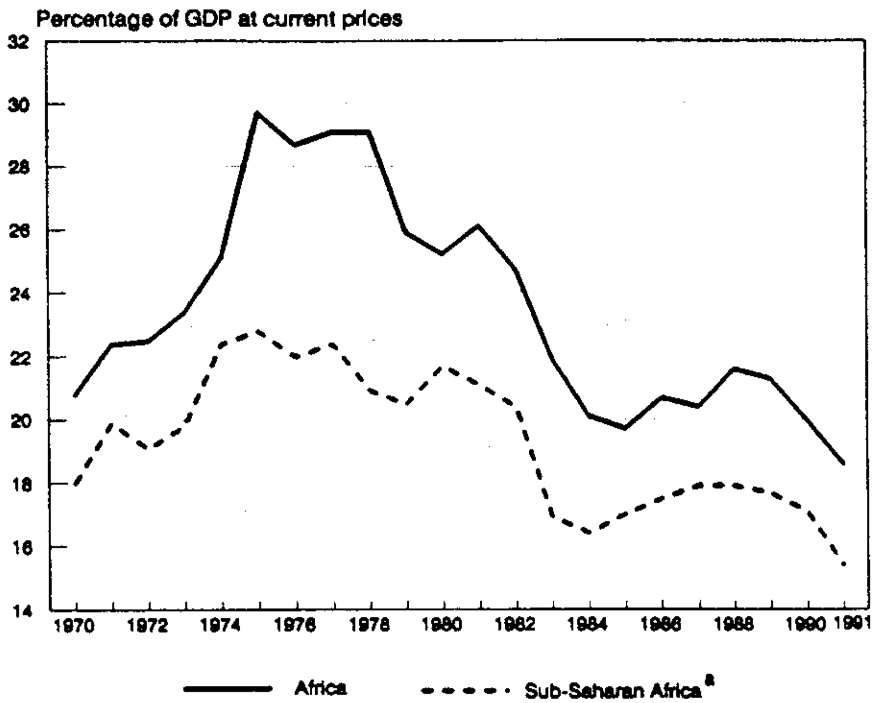
Thirdly, investment continues to be hampered by the legal and administrative framework. Several countries have taken measures to improve this framework to attract foreign investment by establishing investment promotion centres and export processing zones, and adopting new investment codes that usually include incentives such as tax breaks, duty-free imports, repatriation of profits and ownership guarantees. Among these are Algeria, Angola, Benin, Cameroon, Congo, Egypt, Ghana, Kenya, Sao Tomé & Principe, the United Republic of Tanzania, Togo, Uganda, Zambia and Zimbabwe. In 1992 Burundi established that any non-traditional exporter could import free of customs duty and receive a tax holiday for 10 years. Similar measures are planned by Burkina Faso, Cameroon, the Comoros, Lesotho, Malawi, Mozambique and Nigeria. All these measures have not been able to increase Africa's share of world foreign direct investment. The increase in volume went largely to the mining sector of energy-exporting countries. Since 1980, foreign direct investment to energy-importing countries remained below half a billion dollars per year (except in 1989), with a small upward trend since 1983, and stayed below the average level of the period 1975-1980.3/

1/ See, for example, Temitope W. Oshikoya, "Macroeconomic adjustment, uncertainty and domestic private investment in selected African countries", Economic Research Papers, No. 16 (Abidjan, African Development Bank, 1992).

2/ Karim Nashashibi and others, "The fiscal dimensions of adjustment in low-income countries", Occasional Paper, No. 95 (Washington, D.C., International Monetary Fund, April 1992), pp. 11-12.

3/ World Investment Report, 1992 (United Nations publications, Sales No. E.92.II.A.19).

Figure II.6. Africa: gross domestic investment, 1970-1991



Source: UN/DESIPA, based on national data.

[a] Excluding Nigeria.

Fourthly, foreign exchange scarcity, associated with debt servicing, low and declining prices of commodities and terms-of-trade losses, has limited the capacity to import capital goods. In addition, the debt overhang is a deterrent to investment, because it imparts a devaluationary bias to the economy and because of the heightened potential that the Government might in the future tax foreign exchange earnings to honour commitments to foreign creditors. In 1992, the value of exports increased somewhat, but the drought forced countries in eastern and southern Africa to increase food imports drastically. In Kenya, Malawi, and Zaire, cutting of aid by donors to foster political changes has aggravated foreign exchange scarcity.

Several countries have liberalized their foreign exchange regimes. Reforms in the foreign exchange market have improved the access of the private sector to foreign currency. Nigeria let the naira float in march 1992. Under the new system, the role of the Central Bank of Nigeria (CBN) was limited to open market operations, but a large potential to influence the market remains, since CBN provides the bulk of the foreign exchange.4/ Countries that in various ways and degrees liberalized foreign exchange controls and broadened access by individuals to foreign exchange in 1992 include Sierra Leone, the Sudan, the United Republic of Tanzania, Zambia and Zimbabwe. Several other countries devalued their currencies in 1992.5/

A number of countries facing emergency situations interrupted liberalization. Kenya reformed its foreign exchange market in 1992 and early 1993 but later reversed the reforms as they proved unsustainable without balance-of-payments support. South Africa tightened exchange controls because investment abroad by South African companies had put the financial rand under pressure. malawi temporarily suspended the normally liberal foreign exchange arrangements owing to foreign exchange shortages caused by aid suspension and drought-related food imports. Similarly, Zaire imposed import quotas when facing the dive of its currency (from 15,600 zaires per dollar in 1991 to 1.6 million in November 1992). Algeria tightened imports of some consumption goods to free foreign exchange for imports of spare parts and other essential goods, given the pressure of large debt-service payments. In early 1993, Nigeria reformed the foreign exchange market again, increasing the role of the Central Bank of Nigeria, and tightened foreign exchange regulation in face of dwindling reserves.

Fifthly, investment has been curtailed because of lack of finance. Access to bank credit is limited owing to high administrative and transaction costs compared to loan size, lack of collateral and the difficulties banks have in assessing credit risk. Credit to the private sector also has to compete with lending by banks to Governments and parastatals.6/ Restrictive

---

4/ Until early 1993, foreign exchange was sold by CBN at a rate close to the parallel rate, the rate at which the bureaux de change sell currency from private sources. Earlier reforms in the foreign exchange markets of Nigeria were reviewed in World Economic Survey, 1990 (United Nations publication, Sales No. E.90.II.C.1 and corrigenda), p. 30.

5/ Angola, Ethiopia, Malawi, Mauritania, Mozambique, Rwanda and the United Republic of Tanzania.

6/ In Nigeria, for example, 88 per cent of state debts to government-controlled banks were non-performing in June 1991 (The Banker (October 1992), p. 29).

monetary policies have also limited formal credit expansion, as was the case in Zimbabwe in 1992.7/Finally, outside South Africa, formal stock exchanges are rudimentary and exist in only a handful of countries.

Insufficient attention has been given to the informal financial sector, although for smallholders and small enterprises it is the dominant source of credit. Informal institutions, such as (rotating) savings and credit associations and other group-based arrangements, have some advantages over formal financial institutions. Because of the personal relations and group control, it is easier to assess credit risk, administrative costs are lower and procedures are simpler and quicker. Linkages between formal and informal institutions can retain some of the positive attributes of the latter while resources are augmented and costs of lending remain low.8/

Last but not least, because most investment is lumpy and irreversible, investors are reluctant to invest when the degree of uncertainty is high. The variability of income and purchasing power in Africa is rather high because of the dominance of rain fed agriculture. Input and output prices can also be hard to predict in countries with high inflation, floating and/or misaligned exchange rates. In the franc zone, for example, foreign investors are holding back and some increase in capital flight has been noticed because of the speculation about CFA franc devaluation. In many African countries, investments have been hampered by an unstable policy environment, resulting from poor policy implementation, sometimes policy reversal, political instability, civil strife and war. Because investors always have the option to wait, sustainability of policies becomes more important than the

---

7/ Low private investment in Ghana has been ascribed to credit ceilings imposed to counteract monetization of foreign aid (see Stephen D. Younger, "Aid and Dutch disease: macroeconomic management when everybody loves you", World Development, vol. 20, No. 11 (November 1992), pp. 1587-1597). Other causes of low private investment are discussed in Ishan Kapur and others, "Ghana: adjustment and growth, 1983-91", Occasional Paper, No. 86 (Washington, D.C., International Monetary Fund, September 1991), pp. 15-16.

8/ IFAD, The State of World Rural Poverty: An Inquiry into its Causes and Consequences (New York, New York University Press, 1992), chap. 7; Savings and Credit for Development, report of the International Conference on Savings and Credit for Development, Klarskovgard, Denmark, 28-31 May 1990 (United Nations publications, Sales No. E.92.II.A.1); P.B. Ghate, "Interaction between the formal and informal financial sectors: the Asian experience", World Development, vol. 20, No. 6 (June 1992), pp. 859-872.

scope of the reform programme, the depth of liberalization measures or price policy.9/

Political instability has negatively affected economic growth, often through its impact on domestic and foreign investment.10/ In the past few years, several countries faced demonstrations, strikes and riots, as well as demands for political change. In several countries, national conferences have rewritten constitutions, allowing multi-party elections, organized referendums on new constitutions, and appointed interim governments. During the transition period instability and uncertainty has often increased. For instance, in Chad and the Congo in early 1992 and in Togo since 1991, the deposed or marginalized ruler and/or the army have tried to reverse the process. Certain groups (based on ethnicity, religion, clan or regional origin), under represented in the economy or the Government in the past, have sought to gain political power, in some cases leading to armed conflicts. Deferred multi-party elections have also prolonged instability in some countries. In 1992, in countries such as Chad, Kenya, Madagascar, Nigeria, South Africa, Togo and Zaire, the political transition has focused the attention of the Government, required resources, and delayed implementation and increased uncertainty of economic policy, with negative effects on investment in several cases. In Zaire investment almost collapsed in 1992 after continued looting, riots, ethnic conflict and extreme economic and political instability. On the other hand, in Benin, the Congo and Zambia, for example, the level of political tension declined during 1992 after a relatively smooth transfer of power. Zambia benefited from the peaceful transition, the comprehensive reform programme the new Government initiated, and donor support, despite public pressure to ease certain reform measures that have affected living standards. For example, the Zambian investment centre, established at the end of 1991, approved more than 440 projects, worth $650 million, during the first nine months of 1992 and during the first 10 months issued 300 licenses, worth $300 million.

Movements towards democracy have been accompanied by more openness and have in some cases given way to protests against economic reform programmes, increasing uncertainty and complicating implementation. In about a dozen countries, strikes and protests against unpaid wages and stipends or against economic policies were

---

9/ See Dani Rodrik, "How should structural adjustment programmes be designed?", World Development, vol. 18, No. 7 (July 1990), pp. 943-944.

10/ See Augustin Kwasi Fosu, "
yPolitical instability and economic growth: evidence from Sub-Saharan Africa", Economic Development and Cultural Change, vol. 40, No. 4 (July 1992), pp. 829-841.

organized in 1992. Among them are Benin, Burkina Faso and Sao Tomé and Principe, countries in which multi-party elections have recently been held. Elections were also held in Cameroon, the Central African Republic (annulled), the Congo, Ethiopia, the Gambia, Ghana, Kenya, Madagascar, Mali, the Niger (in 1993), Senegal (in 1993) and the Seychelles. Although potentially destabilizing in the short run, there is no simple answer to short-term stability in the course of transition to democracy, but in the medium and long run a stable political environment for economic activity might depend on reforms that consolidate democracy and that go beyond holding formal elections.11/

11/ African Charter for Popular Participation in Development, Arusha, 12-16 February 1990, (E/ECA/CM.16/11); The State and the Crisis in Africa: In Search of a Second Liberation, report of the Mweya Conference in Uganda, 12-17 May 1990 (Uppsala, Dag Hammarskjöld Foundation, 1992); and Rodrik..., p. 935.