

Distr.: GENERAL

E/ECA/CM.21/7  
30 March 1995

Original: ENGLISH

**UNITED NATIONS  
ECONOMIC AND SOCIAL COUNCIL**

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**ECONOMIC COMMISSION FOR AFRICA**

Sixteenth meeting of the Technical  
Preparatory Committee of the Whole

Addis Ababa, Ethiopia  
24-28 April 1995

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Thirtieth session of the Commission/  
twenty-first meeting of the Conference  
of Ministers

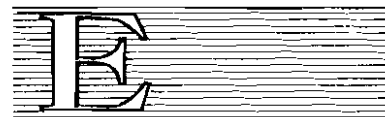
Addis Ababa, Ethiopia  
1-4 May 1995

**Reviving private investments in Africa:  
Policies, Strategies and Programmes**



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**REVIVING INVESTMENT IN AFRICA:  
CONSTRAINTS AND POLICIES**

## I. INTRODUCTION

1. Since 1980, extensive efforts have been directed at generating economic recovery in Africa. However, little attention has been given to the need to promote investment, although investment is essential in any country in order to: (a) increase employment; (b) reduce poverty; and (c) enhance economic growth. Furthermore, in order to feed and provide its growing population with productive jobs, African countries must raise the levels of domestic savings and investment. Unfortunately, policy makers do not tend to give much practical attention to such a link between investment and socio-economic progress. Policies currently being implemented or considered, no matter how genuine, cannot revive the continent's ailing economies unless they accord investment the attention it deserves.

2. Although there are several explanations for the continent's poor economic performance since 1980, the low levels of domestic investment is a major causal factor. Gross fixed capital formation has declined in Africa, from a total of \$76.3 billion in 1980 to \$58.9 billion in 1989.

3. A major cause of the poor state of investment is the very low level of foreign direct investment (FDI), which is the main form of foreign private capital inflows to Africa. These inflows averaged only \$2 billion annually between 1981-1985 and \$3 billion between 1986-1990, accounting for only 3 and 2 per cent, respectively, in the total inflow to developing countries. The average annual growth rate for the second half of the decade is only half that of the first (table 1).

4. African countries have failed to substitute the declining trend of FDI with increasing local investment because of a number of factors, such as the low level of domestic savings as shown in table 2. The African savings ratio in the 1980s was about 63 per cent that of the Asian average.<sup>1</sup> There is also a strong influence of negative net transfers on national savings.<sup>2</sup>

5. The purpose of this paper is to:

(a) Review the investment climate in Africa, identify and analyze the various constraints and obstacles to the expansion of domestic and foreign investments in Africa; and

(b) Further analyze current policies and practices and reflect on possible avenues for improvement in the light of determinants of domestic and foreign direct investment flows.

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<sup>1</sup> For the empirical evidence on most of these, see Abebe Adera, The Financial Sector and Economic Development: Reflections on Africa, Finafrica - Cassa di Risparmio delle Provincie Lombarde (CARIPLO), Milan, 1994; and the Global Coalition for Africa, African Social and Economic Trends, December 1993, pp. 25-26. Aggregate savings are low because of low per capita incomes, low exports/GDP ratios, high and variable inflation rates, low interest rates, poor financial intermediation, relatively high aid flows, which are negatively correlated with domestic savings in some countries, and high birth rates which increase the proportion of the population under 15.

<sup>2</sup> ECA, "Revitalization of investment for Africa's development: Prospects in the 1990s and beyond", background paper for the Ad hoc Expert Group Meeting, 29 November - 1 December 1993. Net transfers were not only negative throughout the 1980s, but their share in gross domestic savings rose from 14 per cent in 1980 to 25 per cent in 1990.

Table 1. Inflows of foreign direct investment to developing economies, by region,  
1981-1985, 1986-1990, 1991 and 1992  
(in billions of dollars and percentage)

Country/economy	Average (billions of \$)				Share in total (%)				Growth rate (%)			
	1981- 1985	1986- 1990	1991	1992 <sup>a</sup>	1981- 1985	1986- 1990	1991	1992	1981- 1985	1986- 1990	1991	1992
All countries	50	155	149	126	100	100	100	100	-1	22	-27	-15
Developing countries	14	26	39	40	28	17	26	32	-4	14	24	3
Africa	2	3	3	2	4	4	2	2	12	6	21	-33
East, South and South-East Asia	5	13	20	21	10	9	13	17	-3	21	8	5
Latin America and the Caribbean	6	9	15	16	12	6	10	13	-10	9	53	7
Oceania	0.1	0.2	0.1	0.5	0.3	0.1	0.1	0.4	-2	27	-57	400
West Asia	0.4	0.4	0.8	0.8	1	0.3	0.5	0.6	7	27	61	0
Other <sup>b</sup>	0.03	0.05	0.1	0.1	0.1	0.03	0.1	0.08	-10	103	35	0
Least developed countries (LDCs)	0.2	0.1	0.2	..	0.3	0.1	0.1	..	-0.4	1	12	..
Ten largest host developing countries	9 <sup>c</sup>	17 <sup>d</sup>	25 <sup>e</sup>	26 <sup>e</sup>	18 <sup>b</sup>	11 <sup>d</sup>	16 <sup>d</sup>	21 <sup>e</sup>	-9 <sup>b</sup>	18 <sup>e</sup>	44 <sup>d</sup>	4

Source: United Nations Conference on Trade and Development (UNCTAD), World Investment Report 1993, New York, United Nations Publication, Sales No. E.93.II.A.14.

<sup>a</sup> Estimated.

<sup>b</sup> Malta and Yugoslavia.

<sup>c</sup> Argentina, Brazil, China, Colombia, Egypt, Hong Kong, Malaysia, Mexico, Nigeria and Singapore.

<sup>d</sup> Argentina, Brazil, China, Egypt, Hong Kong, Mexico, Nigeria, Singapore, Taiwan Province of China and Thailand.

<sup>e</sup> Argentina, Brazil, China, Indonesia, Malaysia, Mexico, Republic of Korea, Taiwan, Province of China, Thailand and Venezuela.

Table 2. The pattern of gross domestic savings in Africa, 1960-1993  
(percentage of GDP at constant market prices)

Geographical/income subgroups	1960	1970	1980	1985	1988	1989	1990	1991	1992	1993
North Africa	12.1	21.4	16.2	16.1	16.6	15.8	15.2	15.1	18.38	18.35
West Africa	9.4	12.9	21.2	16.2	16.7	5.86	6.58	6.31	5.98	6.01
Central Africa	15.5	19.5	19.6	19.7	20.5	8.96	8.0	7.68	7.80	5.03
East/Southern Africa	14.6	15.0	17.5	14.4	15.0	7.81	7.65	7.25	8.23	6.90
Major oil exporters	13.5	22.5	35.1	26.5	28.7	5.83	6.63	6.63	6.03	6.27
LDCs	6.6	10.3	4.0	4.6	4.9	N/A	N/A	N/A	N/A	N/A
Others	19.0	16.0	17.4	19.3	18.7	N/A	N/A	N/A	N/A	N/A
Developing Africa	12.4	17.8	18.6	16.8	17.5	N/A	N/A	N/A	N/A	N/A
Asia	19.1	25.4	30.3	26.3	N/A	N/A	N/A	N/A	N/A	N/A
Latin America	19.5	21.6	22.0	22.1	N/A	N/A	N/A	N/A	N/A	N/A

Source: ECA secretariat 1994.

## II. CONSTRAINTS ON INVESTMENTS

6. Africa's bid for enhanced domestic and foreign investment flows cannot yield positive results if adequate solutions are not found to the inhibiting factors. These factors are reviewed in the following sections of this paper.

### A. Inadequate macroeconomic frameworks and irrelevant approaches to structural adjustment

7. In the majority of African countries, the macroeconomic policy framework is that of the current International Monetary Fund (IMF)/World Bank induced structural adjustment programmes (SAPs).

8. It is a fact that current SAPs, designed to address Africa's economic problems, have not succeeded in reversing the declining trends in investment, even in relatively stable countries with a long history of adjustment. Part of the answer is provided by the World Bank in its most recent study on SAPs in Africa:

*"Investment generally responds slowly to adjustment in Africa and elsewhere. This slow response is understandable. Investments cut capital spending as part of their fiscal stabilization - while the private sector adopts a wait-and-see attitude during the early phases of adjustment due to the irreversibility of investment decisions and the reversibility of key policy changes (frequent in previous episodes). The problem is particularly serious where there is no consensus about the importance of private-sector-led growth".<sup>3</sup>*

9. Additionally, the absorption-reducing effects of both fiscal and monetary policies in SAPs not only reduce public capital spending (as shown in the sample of countries in table 3), but indirectly and directly reduce private investment through interest rate rises and the complementarity between public and private investment. Current SAPs, by their heavy emphasis on massive devaluations, tend also to induce a deflationary spiral, which bears a negative relationship to private investment. In fact, experience confirms that such devaluations can themselves be the cause of macroeconomic uncertainty. Thus, it is not surprising

<sup>3</sup> World Bank, Adjustment in Africa: Reform, Results and the Road Ahead (Washington, D.C.: The World Bank, 1994), p. 124.

that evaluations by some World Bank researchers found that not only did non-adjusting countries outperform adjusting countries in exports, domestic savings and inflation, but also in investment.<sup>4</sup>

10. It is relatively easy to realize that Africa needs much higher levels of investment to revive its economies. Such investment is essential in all sectors, such as education, health and agriculture. In particular, the continent needs very large doses of capital in its export goods sector in order to compete in the new world era created by the end of the cold war and the emergence of regional trading blocs. Such investment is also essential in alleviating Africa's huge debt burden, the magnitude of which is shown above. However, the difficulty that African policy makers now face is how to attract domestic and foreign investment at the present time, after overcoming the hostility in the 1960s and 1970s towards private capital. In fact, this predicament tends to be the main explanation behind the inadequate attention of policy makers to investment promotion in Africa.

Table 3. Gross public investment in selected countries  
(% of GDP)

Country	1980	1988	1989	1990	1991	1992	1993
Burundi	12.2	13.4	14.7	15.2	14.3	16.2	N/A
Côte d'Ivoire	11.4	6.0	3.9	4.2	3.9	3.4	2.8
Gabon	5.3	1.9	2.4	2.4	4.4	4.1	4.2
The Gambia	17.0	5.3	5.1	5.2	6.2	6.8	N/A
Kenya	10.4	8.3	8.1	9.8	8.6	7.6	6.3
Malawi	17.5	8.2	7.3	7.8	8.0	9.4	7.4
Mauritius	8.4	4.3	4.1	4.2	4.7	5.1	5.4
Senegal	5.9	3.9	4.2	4.1	4.1	4.0	4.2
Tanzania, United Republic of	11.6	12.2	15.9	15.2	12.5	12.7	N/A
Togo	21.9	13.2	12.2	13.8	13.4	9.8	2.7
Zaire	5.1	6.7	N/A	N/A	N/A	N/A	N/A
Zimbabwe	4.7	6.7	N/A	N/A	N/A	N/A	N/A
Zambia	15.0	9.6	N/A	N/A	N/A	N/A	N/A
Average	11.3	8.1	7.8	8.2	8.0	7.9	4.7

Source: United Nations Development Programme (UNDP)/World Bank, African Development Indicators, 1994-1995.

#### B. Inadequate infrastructural and human capital

11. Investors, both domestic and foreign, are naturally hesitant about investing in countries where basic requirements, such as roads, health services and utilities are inadequate. Because of the lack of adequate infrastructure, as stated above, it is common for investors to provide their own back-up generators, medical

<sup>4</sup> I.A. Elbadawi, "Have World Bank-supported adjustment programmes improved economic performance in sub-Saharan Africa?", Policy Research Working Papers No. 1001, the World Bank, 1992; and Elbadawi, I.A., et al., "Why structural adjustment has not succeeded in sub-Saharan Africa", Policy Research Working Papers No. 1000, the World Bank, 1992.

care and access roads, even in industrial estates provided by governments. These increase the costs of doing business and reduce the rate of return on investment; thus turning away both types of investors.

12. In African countries many forms of business ventures are prevented by the lack of skilled personnel. This calls for greater investment in human capital. Human capital investment on health and education, including institutional and on-the-job training, as well as adult literacy programmes, could overcome obstacles to productivity and higher earnings by the labour force and ill health, lack of illiteracy, lack of skills and adaptation to technology, poor incentives and immobility could be reduced. Furthermore, the capacity to absorb physical capital may depend on investments in human capital.<sup>5</sup> In the case of developing countries, the World Bank in 1980 found that, in fact, the economic rates of return on investment in education were higher than in developed countries. In the same survey, it was found that human capital also yielded higher rates of return than non-human capital.<sup>6</sup>

### C. Deteriorating economic and social conditions

13. Africa's economic crisis is further exacerbated by natural and man-made calamities, including cyclical droughts and internal conflicts. These are, indeed, major inhibiting factors running counter to the continent's efforts to attract foreign direct investment.

### D. Lack of political stability

14. Another related and equally unfavourable force is political instability. Africa today is not only facing an economic crisis characterized by famine, malnutrition, high rates of unemployment, refugees, and severe poverty, but is also burdened by serious political problems, including one-person rule, violation of human rights, inter-ethnic and interregional conflict, and the lack of tolerance for minority groups. All these problems have projected an image that Africa is a region riddled by crises and not conducive to investment. As a result of the political crisis that engulfed Africa in the 1980s and the 1990s, many investors have developed a perception that investing in Africa is "unsafe".

15. Besides political instability, the likelihood of expropriation contributes to the lack of investor confidence. Predictability of conditions and lack of arbitrariness may be the most important assurance that can be offered to investors, who seem able to adapt to practically any conditions as long as the rules are clearly established in advance and followed subsequently.

### E. Low rates of return on investment

16. The rate of return on investment in Africa has declined significantly over the years and more precipitously during the past decade. According to the World Bank, rates of return in sub-Saharan Africa have dropped from around 30.7 per cent in 1961-1973 to around 2.5 per cent in 1980-1987. On the other hand, during that period the rate of return in South Asia, for instance, grew from 21.3 to 22.4 per cent.<sup>7</sup>

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<sup>5</sup> W. Schultz, "Investment in human capital," American Economic Review, March 1961; M. Blaug, "The rate of return on investment in education to national economic growth", Journal of Political Economy, October 1964; E.F. Denison, Trends in American Growth 1929-82 (Washington, D.C.: the Brookings Institutions, 1985).

<sup>6</sup> World Bank, Education Sector Policy Paper, 1980.

<sup>7</sup> World Bank, Sub-Saharan Africa: From Crisis to Sustainable Development (Washington, D.C., World Bank, 1988).

#### F. Chronic shortage of foreign exchange

17. The chronic and persistent shortage of foreign exchange and restrictions on foreign currency transfers is also considered as a serious constraint facing investors in Africa. The problem of foreign exchange shortages means that spare parts cannot be imported which, in turn, means that existing plants have to operate well below capacity. In addition, infrastructural facilities cannot be properly maintained, nor can the imports of the necessary consumer goods be made. Investment is not encouraged when such conditions prevail, and instead, disinvestment takes place.

#### G. Domestic and external debt burden

18. The situation has been further aggravated by the increase in external debt, which has grown from \$93 billion in 1980 to about \$240 billion in 1987 and \$281 billion in 1991. In 1993, total African debt (excluding South Africa) reached \$285.4 billion. This comprised \$118.9 billion for North Africa and \$166.5 billion for sub-Saharan Africa. These figures represent changes of 3 per cent in the total regional debt, a decline of 0.5 per cent in that of North Africa and a 6 per cent increase in that of sub-Saharan Africa since 1990. In absolute terms these amounts are small. The total debt in 1993 represented only 16 per cent of total developing country debt.<sup>8</sup>

19. However, the magnitude of what is now generally recognized as the "African debt crisis" becomes more clear from the ratios that express the debt in relation to certain key economic variables. Therefore, in 1993, the debt/GDP ratio equalled 73.3 per cent for North Africa and 123.1 per cent for sub-Saharan Africa. This means that, in the case of sub-Saharan Africa, for instance, the debt owed far exceeded the total value of goods and services of the entire region. In such a situation, the entire economy of Africa can be correctly regarded as less than adequate collateral for current and future debt. Secondly, for North Africa, the debt-service ratio equalled 37.6 per cent and for sub-Saharan Africa it equalled 13.2 per cent in 1993. The relatively low ratio for sub-Saharan Africa is due to the numerous debt rescheduling and the accumulation of arrears that have taken place in recent years.

20. Yet, such aggregate figures mask even more worrying cases at the country level. For example, the debt/GDP ratios for Côte d'Ivoire, the United Republic of Tanzania, Guinea-Bissau and Mozambique equalled 206, 285, 323 and 386 per cent, respectively. The debt-service ratios for Burundi, Côte d'Ivoire and Uganda equalled 41, 43, and 56 per cent of their export earnings, respectively. When the servicing of external debt takes so much of a country's export earnings, foreign investment will be discouraged simply because investors become uncertain that the country will be able to authorize the remittance of profits and provide foreign exchange for the necessary imports. Investors are very risk-averse in such an environment. Uncertainty negatively affects investors' expectations and, hence, their calculations of expected returns, which are heavily influenced by risk perceptions. Domestic investors can also be discouraged from investment when the debt is too large because a debt overhang distorts the incentive to invest since the benefit of good performance goes to creditors rather than the debtor. Furthermore, investors expect high taxation in the face of a debt overhang in order to enable the government to service its debt.<sup>9</sup> Domestic debts are equally inhibiting factors: they affect domestic savings, corporate efficiency and domestic investments and may even lead to disinvestment.

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<sup>8</sup> World Bank, World Debt Tables, various issues.

<sup>9</sup> Karamo N.M. Sonko, Debt, Development and Equity in Africa (Lanham, MD. University Press of America, 1994); J. Sachs, "The debt overhang of developing countries", in Guillermo Calvo *et al.*, (eds.), Debt, Stabilization and Development: Essays in Honour of Carlos Diaz-Alejandro [Helsinki: World Institute for Development Economic Research (WIDER) 1984]; and P. Krugman, "Financing vs. forgiving a debt overhang", Journal of Development Economics, vol. 29, 1988, pp. 253-268.



#### H. Cumbersome investment legislation and procedures

21. Other inhibiting factors are related to the slow response of host governments, complicated requirements, inefficiency, corruption, bureaucratic processes and government decision making.

#### I. Insufficient/inefficient incentive packages

22. Most African countries have, indeed, enacted generous investment codes, yet in many other African countries the investment incentive packages have not yielded the expected results because of the deterrent effect of excessively high corporate taxes, high interest rates not in line with the requirements of productive investments, inadequate depreciation allowance systems contributing to high capital costs, uncompetitive wage rates and rigid labour codes.

#### J. Inefficient financial sectors

23. The financial sector is crucial to the development of any economy. The institutional set-up of the financial market is important in the transmission of monetary and credit policy effects on investment. While there are both foreign and locally owned commercial banks in many African countries, merchant banks are few and they have concentrated mainly on trade finance and less so on the mobilization of medium to long-term investment finance. Commercial banks are located mainly in urban centres with very few and not so well-dispersed branches in rural areas which constrains their financial intermediation. Also, the lending operations of development banks, which were established to finance capital projects, have been plagued by poor lending policies or government interference resulting in heavy investments in large projects with low economic rates of return. As a result of these factors, the financial sector remains undeveloped, inefficient and inaccessible to most savers and credit-seekers. These factors account for its failure to adequately mobilize domestic savings and to attract foreign capital for domestic investment.<sup>10</sup> In a sample of 12 African countries in the late 1980s, the M<sup>2</sup>/GDP ratios range from only 0.114 per cent in Rwanda to 0.225 per cent in Benin.<sup>11</sup>

24. The development of capital markets has recently gained momentum in a few countries, in addition to six principal stock exchanges in Côte d'Ivoire, Egypt, Kenya, Morocco, Nigeria and Zimbabwe. But the existing capital markets are suffering from grossly inadequate capitalization. The factors inhibiting foreign and local investment in the local capital markets include low fiscal incentives, lack of market information, insufficient investment protection, lack of participation by financial institutions as underwriters and brokers, and the restrictions on profit and dividend repatriation by foreign investors.

25. So far, the informal sector has not been given adequate attention in terms of its potential in non-bank financial intermediation, particularly in the rural areas in Africa. Money lenders, community savings organizations, and non-institutional forms of saving and credit arrangements would appear to have enormous capacity to tap the savings potential of some 80 per cent of Africans who live in the rural sector. However, the lack of an organized framework to link these informal financial intermediaries with formal financial institutions is depriving African economies of an important source of savings for domestic investment.

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<sup>10</sup> S.E. Omoruyi, "The financial sector in Africa. Overview and reforms in economic adjustment programmes", Economic and Financial Review of the Central Bank of Nigeria, vol. 29, No. 2, June 1991.

<sup>11</sup> Abebe Adera, The Financial Sector and Economic Development: Reflections on Africa, Finafrica - CARIPLO, Milano, 1994.

### K. Inefficient domestic resource mobilization

26. In Africa, like anywhere else, foreign investment should play a significant role in economic growth. However, domestic resource mobilization must form the core of growth in order to attain self-reliant and sustainable development. Among other measures, domestic resources can be mobilized through realistic interest rates on domestic savings, integration of informal economic activities into the formal sector, more efficient banking systems, easier access to domestic credit for investors, appropriate investment incentives, special training and financial assistance to small-scale entrepreneurs, etc.<sup>12</sup>

27. The main source of domestic revenue in African countries is taxes, particularly indirect taxes on international trade. On average, tax revenues equal around 20 per cent of the GDP of sub-Saharan African countries, while indirect taxes on exports and imports account for 45 per cent share in government revenue. Taxation is a widely prescribed measure to raise public revenues and governments use their taxable capacity to generate high tax ratios. During the late 1970s, the average tax ratio for sub-Saharan Africa was 18 per cent but, by 1985, tax revenues as a percentage of GDP rose to 23 per cent. Despite this trend, the loss of export receipts, resulted in a substantial loss of revenues.

28. The overdependence of African countries on a narrow tax-base which is tilted heavily towards indirect taxes on international trade has been problematic in the 1980s because of depressed commodity markets and tax reforms. Revenue collection has been unstable, fluctuating widely with movements in export receipts which have declined or stagnated, causing import demand to shrink in many countries in the region. Even though it is easier for governments to raise additional revenues through higher taxes on foreign trade, this is becoming increasingly difficult due to a reduction of import duties and export taxes. In any case, the collection of trade taxes has always been undermined by smuggling and tariff evasion, as well as corrupt tax administrations.

29. The generally low income levels in the region and the narrow corporate base, make personal income and corporate taxes, unviable alternatives for enlarging domestic savings. In fact, as part of investment incentives, many countries, for example, Kenya and the United Republic of Tanzania, in 1992 reduced corporate taxes to competitive levels in order to lure domestic and foreign investors.

### L. Narrow national markets

30. Domestic markets are narrow and often fragmented. This is further exacerbated by the insufficient liberalization of intra-regional trade, thus limiting trading opportunities for potential investors.

### M. "Image issue"

31. Last, but not least, is the negative perception of Africa. Beyond economic policies and issues, the major obstacle Africa has to overcome in attracting foreign investment is that of negative attitudes towards the continent. More than any other continent, Africa has long suffered from adverse media and academic exposure. The stereotypical image of the continent is that of corrupt dictatorships, hunger and starvation, ethnic wars, coup d'états and now AIDS. The result is a sense of apathy and pessimism, even within the continent itself. A part of such attitudes is deliberately prejudicial, sometimes justified by events and the behaviour of some governments in Africa, as stated earlier, but a part is simply due to the lack of adequate information about the continent.

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<sup>12</sup> Karamo N.M. Sonko, "The management and promotion of small-scale enterprises: Field evidence from Ethiopia", paper presented at the Senior Policy Workshops on SMEs, Addis Ababa, Ethiopia, 14-17 November 1994.

N. Improving the investment climate in Africa

32. Judging by the extent of Africa's economic, social and political crises, this would be a monumental task. Yet it is not impossible. Considering Africa's rich natural resource base, abundant human resources and the country-specific advantages of many African nations, they could compete in global capital markets. The policies and means of attracting both foreign and domestic investment are addressed in the following paragraphs.

(a) Setting relevant macroeconomic policy frameworks and providing the public sector with a proper role

33. The initial step is to restructure expenditure in favour of spending on infrastructure and services, as well as human capital and institutional capacity.<sup>13</sup>

34. African countries can reduce risk through macroeconomic stability. This means that inflation has to be controlled, exchange rates stabilized and interest rates set at realistic levels. Government action is required to introduce fundamental changes in the macroeconomic environment, stimulate private investment through the removal of distortions in the incentive structure and to encourage a more efficient allocation of resources and factor inputs in line with resource endowment and national development objectives.

35. The promotion of the investment climate in Africa requires a clear perception of the proper role of the public and private sectors in economic development. At this stage of Africa's development, the two sectors should be developed simultaneously, not one at an unnecessary cost to the other. The current emphasis on private sector development in Africa should be pursued. In the process, however, the public sector should not be deprived of its role in creating an enabling environment for the private sector nor from undertaking necessary investments in the economy. Doing so will make the objective of private sector development unattainable.<sup>14</sup>

(b) Defining and implementing proper incentive packages

36. Investment incentive systems are the main policy instruments that can directly influence the volume and allocation of investment. In view of the competitive global investment environment, African Governments should undertake a complete overhaul of their investment incentive packages, taking into account the experiences of other developing regions. Some of the issues that need to be addressed are the impact of tax concessions, minimum wage and employment legislation, interest rate policies, training allowances, depreciation allowances, policies on the repatriation of profits and foreign exchange transactions.

37. Tax concessions, interest rate policies and accelerated depreciation allowances should be formulated in a manner to lower the cost of capital. The tax incentives should be assessed both in absolute terms and in relation to tax rates and concessions that potential investors are likely to obtain elsewhere. Some empirical studies have shown that minimum wage levels in Africa are higher than in other developing regions. It is imperative for wage rates to be established within the overall context of an investment

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<sup>13</sup> Karamo N.M. Sonko, "Investment: A key to Africa's recovery", Brussels: Club de Bruxelles, mimeo, June 1994.

<sup>14</sup> See Karamo N.M. Sonko, "A tale of two enterprises: Swaziland's lessons for privatization", World Development, vol. 22, no. 7, 1994, pp. 1083-1096; and Karamo N.M. Sonko, "The promotion and management of small-scale enterprises: Field evidence from Ethiopia", paper presented at the Senior Policy Workshop on Small-scale Enterprises, Addis Ababa, Ethiopia, 14-17 November 1994.

incentive system, taking into account the prevailing conditions in other developing regions.<sup>15</sup> Relatedly, the effects of labour laws on employers is an area that needs careful attention. Investors do not like to be denied their right to "hire and fire" workers, and any attempts to do so may force them towards the use of more capital-intensive technologies.

38. Incentive packages should include a training component for nationals through investment allowances. This will effect the transfer of skills and adaptability of technologies. Appropriate measures should be devised to increase the access of investors to foreign exchange for the importation of essential inputs and, for the repatriation of profits. Time is essential in investment decision making and the operation of business. Bureaucratic time-consuming procedures should be avoided in the consideration of investment applications and the administration of investment concessions. "One-stop" investment centres could help to do this. An important factor in improving the investment climate in Africa is to develop legislation that is credible, permanent and consistent with the national investment code. Laws should be transparent, non-discretionary and applied fairly to all investors. Investors should feel a sense of legal security at all times.

(c) Tackling the domestic and external debt obstacles to enhanced investment flows

39. The first step to be taken by African Governments in this direction is to ensure proper management of their current debts by establishing up accurate debt databases and acquiring management and negotiation capacities in this domain. It is equally important to ensure that new debts are directed to resource-generating projects contributing to enhancing payment capacities of African countries.

40. Africa's creditors should accept that Africa's viability can only be built with positive transfer flows. This requires measures for the alleviation and/or cancellation of sizable volumes of the continent's external debts and resorting to swap operations (debt-equity swaps and various types of debt-development swaps) linking external and internal debts with investments and growth through, inter alia, the privatization process.

41. African Governments should give priority to settling internal debts, especially those owed to productive enterprises; this would help maintain productive activities, safeguard employment and promote re-investment.

(d) Optimizing rates of return on investments

42. This could be achieved through efficient incentive packages and the simplification of documents and procedures including:

(a) Reasonably attractive corporate taxes which may be obtained with the expansion of the tax base to new areas coupled with a more efficient and effective tax collection;

(b) Discriminatory (bontified) interest rates to allow profitable investments;

(c) Depreciation allowance systems contributing to cuts in yearly capital costs (low provisions);

(d) Flexible labour codes and dynamic wage/salary systems allowing, through a variable element, incentives for enhanced productivity.

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<sup>15</sup> F. L. Osunsade, "Impacts of adjustment programs: Concern for the human condition", in V. Nanda et al., World Debt and the Human Condition: Structural Adjustment and the Right to Development (Westport, CT.: Greenwood, 1993).

43. Simplifying documents and procedures through a single window system and enhancing the liberalization of business operations could also contribute to higher rates of return as they would help cut investment costs and operations.

(e) Increasing public investment towards human development and infrastructural development

44. The budget allocation process should take into account the priority accords of these two key pre-requisites to enhanced investment flows. Due regard should be accorded to the social rate of return in these domains which should be seen as participating in productive activities (and not as unproductive investments). Resources should be allocated to provide for adequate health services and efficient professionally oriented educational systems to build adequate human capital bases. Industrial estates with good infrastructural networks (roads, electricity, telephones) should be promoted by governments to cut basic investment costs.

(f) Building reliability through political stability, predictable sets of rules and regulations and continuity in the supply of foreign currency for input imports and transfers

45. Reliability is a very important element for investors. Policies should therefore be adopted towards effectively ensuring this through:

(a) Political stability: this requires the democratization of public life and popular participation, so as to ensure peaceful transitions;

(b) Predictable sets of laws, rules and regulations, adopted in good faith, and clearly stipulated in agreements with investors;

(c) Foreign currency allocation systems should be put in place with due regard to the priority that ought to be accorded to the requirement of productive activities. Discriminatory measures should be adopted through the acceptance of negative lists and in favour of input imports and contractual transfers. These discriminatory measures are necessary in an environment of scarce foreign currency revenues.

(g) Enhancing financial intermediation

46. The banking and non-banking financial systems should be shaped to play their role in promoting productive investments and providing efficient services to investors and corporate activities. The speculative bias of current credit and monetary policies should be looked into and remedied. Banks should be urged to consider funding productive investments. Investment banks should also be encouraged.

47. The development of a capital market is another important avenue for enhanced financial intermediation. African Governments should promote the establishment of such instruments and envisage their regionalization in the medium and long term.

(h) Enlarging markets: the need to promote regionalism in Africa for enhanced investment flows

48. The regional approach is also important in order to draw investors' attention to opportunities not only within but across nations. Since the total GDP of Africa is only equal to that of Austria *alone*, the small size of national economies is a disincentive to investors.<sup>16</sup> The existence of regional markets makes it

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<sup>16</sup> Abdelkader Allaoua and Michael Atkin, "Foreign direct investment in Africa: Trends, constraints and challenges", Ad hoc Expert Group Meeting on the Revitalization of Investment in Africa: The 1990s and Beyond, Addis Ababa, Ethiopia, 29 November - 1 December 1993.

possible for small African countries to become hosts to transnational corporations (TNCs). Therefore, Africa's current efforts at regional integration can be another way of attracting investors. Regional integration should be accorded all the enthusiasm that it deserves. In this regard, the intent of the Abuja Treaty establishing the African Economic Community by the year 2028 should be pursued by all African Governments.

49. The effectiveness of present regional organizations has been limited by a host of factors, including political and financial support of member countries. These organizations should be restructured at the levels of both policy and production, and supported by the necessary financing, administrative and organizational backstopping. The recent initiative of the African Development Bank (ADB) to establish an African export/import bank deserves serious commitment by all concerned partners. Such a bank could contribute immensely in boosting intra-African trade.

(i) Improving the world's perception of Africa: abolishing the continent's negative image

50. Where the lack of information is the cause of such stereotyping and the consequent shying away from Africa by potential investors, a general information campaign could make a great difference. The aim of such a campaign should be to emphasize the positive aspects of African countries and economies. The world should be aware that there are countries which continue to enjoy relative political and economic stability. Some of these were at one time among the fastest growing economies in the world. It should be known that there are African democracies, imperfect as they may be, like anywhere elsewhere. The strengths of African culture and the unrivalled hospitality of Africans should be brought forward. The world should be informed that like Asia and the rest of the world, Africa has its good parts too, and sometimes even better than elsewhere. The African diplomatic community, African-owned papers abroad, African correspondents of the foreign media, international development agencies and foreign friends of Africa, could all help in such an urgent venture.

51. The benefits of such a campaign could be immense. First, it could convince potential investors to pay more attention to Africa. Second, it could influence the behaviour of African governments in creating conditions attractive to investors. The record of the modern mass media and the experience of South-East Asia show that these objectives can be attained.

52. However, some coordination will be necessary in doing this. Currently, some countries are devoting huge resources directly or indirectly, without any significant impact. For cost-effectiveness and greater impact, regional institutions and organizations, such as ECA, ADB, the Organization of African Unity/African Economic Community and the various subregional groupings should launch collective campaigns on behalf of their member countries.

53. Africa's efforts to offer a more attractive investment climate should, indeed, be supported by the international community at large and at the technical/promotional level by the relevant regional and international organizations.

(j) The role of the international community

54. It is in the long-term interest of the international, particularly donor, community to encourage the flow of foreign investment into Africa. This is the only viable way of shifting Africa's dependence from aid to trade and putting an end to the pressures for aid on the donor community. It is also the best way of making Africa an effective partner in global trade and income growth, as the current poor trade performance of Africa has, in effect, depressed both African and global income through minimal export earnings and stunted import demand.

55. Africa's development partners could help improve the investment climate in the continent in three ways:

(a) Channelling increased concessional flows (aid and soft loans) into infrastructural development projects, research, education and health to help create the required enabling environment for increased private investments in Africa;

(b) Helping Africa out of its debt shackles through meaningful debt reduction and debt-development swaps (including debt-equity swaps), with a view to restoring financial viability and confidence in the continent;

(c) Supporting external investments by providing reliable guarantees through their national guarantee systems and Multilateral Investment Guarantee Agency (MIGA).

56. Organizations within the United Nations system and other international organizations should step up their assistance to Africa in four directions:

(a) Advisory services to members and their national institutions in the formulation of macroeconomic policies, investment incentive packages and project identification;

(b) Building and development of sustainable institutional and human capacities to back Africa's efforts to attract domestic and foreign investments. In this regard, every effort should be deployed to strengthen training and research capacities within centres such as the African Regional Centre for Technology (ARCT), the African Regional Centre for Design and Manufacturing (ARCEDEM), the Food Technology Institute (FTI), etc., and national investment promotion centres;

(c) Staging of relevant promotional events to create opportunities for contacts between African promoters (public and private) and African and foreign investors and to put forward Africa's potential and comparative advantages;

(d) Support of efforts to build up and expand African capital markets.

57. ECA's recent and ongoing activities in this domain should be seen within this framework. The Commission has planned, carried out and/or supported the following activities:

(a) The African capital market forum

58. In view of the importance of capital markets in promoting investment in Africa, ECA has been involved in a number of meetings since 1992 to discuss modalities of developing capital markets in the continent. The first of these took place in Abuja, Nigeria, from 11-13 November 1992, followed by another one in Nairobi, Kenya, from 18-20 August 1993.

59. A five-member steering committee, including ECA, was elected at the second meeting in order to make recommendations on the establishment of an Africa capital markets forum for the promotion of formal capital markets in Africa. ECA is the secretariat of the committee. This committee has now completed its work and the forum will be launched officially at the forthcoming ECA investment promotion conference.

(b) The investment promotion conference/forum

60. It is in the light of its recognition of the vital role investment can play in the economic recovery of Africa and the inadequate attention so far accorded to coordinated efforts at boosting investment in the continent that ECA is planning to hold an investment promotion conference on "Reviving private investment

in Africa: Challenges and opportunities". The meeting will be organized by ECA, with the support of ADB, UNDP, the World Bank Group, the African Business Round Table, the European Commission (EU), the United Nations Industrial Development Organization (UNIDO), UNCTAD, the Islamic Development Bank (IDB), the Centre for the Development of Industry (CDI), the Global Coalition for Africa (GCA) and other agencies.

61. The objectives of the conference are to:

(a) Bring together African government officials at the highest levels, African private entrepreneurial men and women, United Nations agencies, foreign governments and private investors, and scholars and students of international business;

(b) Provide a better understanding of the needs and means of public/private partnership in African economies;

(c) Increase the awareness of potential foreign investors of the opportunities of investment in African economies;

(d) Provide an opportunity for joint ventures among Africans and between Africans and their foreign counterparts;

(e) Increase awareness of African policy makers of the factors discouraging domestic and foreign investors in Africa and the role of governments in changing the situation;

(f) Enhance the bargaining skills of African policy makers for attracting investment;

(g) Increase Africa's awareness of the investment potentials of non-traditional partners in general and Asia in particular; and

(h) Provide a better understanding of how integration can be a means of improving the investment climate.

62. Participation at the conference will be drawn from the following:

(a) A number of African Heads of State;

(b) Private business corporations, firms and individuals from Africa and abroad;

(c) African Governments, represented by a Minister of Finance and/or Trade from each country;

(d) Women's business associations. These should be given particular attention;

(e) Scholars from universities and institutions of higher learning from the United States of America, Europe, Asia, African business schools and research centres;

(f) ADB, African Business Round Table, OAU, EU, Commonwealth Secretariat, 90 diplomatic missions in Addis Ababa, UNDP, World Bank, UNIDO, United States Agency for International Development (USAID), African Economic Research Consortium (AERC), UNCTAD, IDB, CDI, African-American Institute (AAI), Canadian International Development Agency (CIDA), Japan International Cooperation Agency (JICA) and other international development organizations;



(g) Stock markets, cooperatives, trade agencies and non-governmental organizations (NGOs);  
and

(h) Major international newspapers and magazines, such as *The Financial Times*, *The Economist*, *The Observer*, *West Africa*, *New African*, *Jeune Afrique*, *Jeune Afrique Economie*, *Afrique Industrie*, etc.

63. It is expected that the conference will:

(a) Create a platform for immediate or future impact on African policy makers to create a more attractive investment climate;

(b) Develop contacts between African economic operators and potential foreign partners;

(c) Result in various publications on domestic and foreign investment in Africa, as well as special features in prominent journals and magazines; and

(d) The formulation and adoption of an action plan for domestic and foreign investment in Africa.

(c) Building collective capacities to support Africa's efforts to promote public and private investment<sup>17</sup>

64. The following actions have been carried out by ECA:

(a) Assistance to African countries to establish centres of excellence: 30 ECA-sponsored Institutions were established to cater for collective capacities in support of investment;

(b) Assistance for the enlargement of national markets into subregional markets through the establishment and strengthening of regional groupings all over the continent;

(c) Pre-feasibility studies for the development of infrastructures and their interlinking were prepared under the UNDP fourth regional cycle programming covering road networks, electricity grids, railways, etc.;

(d) Preparation of industrial master plans and studies on potentialities for industrial investments.

### III. CONCLUSION

65. The importance of private and public investment in Africa's growth and development cannot be overemphasized.

66. Africa has therefore to brace itself and resolutely enter stiff international competition to attract much needed private capital flows from within the continent and from foreign sources.

67. Africa's potential for investments is immense yet constraints on the investment climate are numerous although not insurmountable. Africa can cope with the constraints by adopting the right policies, formulating and implementing the right incentive packages. Establishing political stability and adopting the right approaches to economic reforms are important prerequisites to an increased investment flow. There is also an urgent need to develop infrastructural and human capacities and to further the economic integration

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<sup>17</sup> The list of studies and the directory of institutions concerned are available for distribution on request.

process so as to offer greater trading opportunities to investors. Not less important are the promotion of a dynamic financial sectors and the adoption of monetary and credit policies conducive to investments in the productive sectors.

68. Africa's efforts should be supported by its development partners and international organizations. The former should consider granting substantive alleviations and the cancellation of the continent's debt burden and creating reliable guarantees for potential investors.

69. Capacity and infrastructural development programmes of African countries should also be supported by increased concessional flows in the context of positive transfers. The relevant international organizations should step up their programmes of assistance to Africa for the promotion of domestic and foreign investment. They should advise on macroeconomic policy formulation, regional economic integration and capacity building to promote an enabling environment for enhanced investment flows.

70. Efficient communication strategies are of the utmost importance in developing a positive perception of African countries and focusing attention on economic potential and opportunities for the redeployment in the world economy (de-localization and new markets).

AnnexTable 4. Changes in main national legislation in relation to foreign direct investment in 1992

Country	Law/Regulation	Content
Egypt	Regulation of June 1991 of the General Authority for Investment (GAFI) of the Ministry of Economy and Foreign Trade.	Expanded areas for foreign investments to include air and sea transport and consultancy services for electricity, water and waste-water projects. Also lists activities where foreign investors are barred and manufacturing activities subject to local-content requirements.
Uganda	The Investment Code, of 25 January 1991.	Establishes the Uganda Investment Authority whose functions are to promote and supervise investments. Foreign investors cannot operate a business without an investment licence. Transfer of foreign exchange requires approval also. Incentives include exemption from import duties and sales tax on machinery and construction items not available in Uganda, plus three-year tax "holidays" from corporate and dividend taxes.
Zambia	Investment Act of 1991.	Establishes an "Investment Centre" as a "one stop" facility for the promotion, coordination, regulation and monitoring of investments. Enumerates incentives granted to licensed investors in specific industries; guarantees include protection of property from expropriation, except upon payment of compensation equivalent to the market value of the property; transfer of profits, interests, royalties and dispute settlement by arbitration.

Table 4 (cont'd)

Country	Law/Regulation	Content
Burundi	Law No. 1/30 on the Creation of a Free Zone in Burundi, of 31 August 1992.	Creates a free-zone regime for export-oriented enterprises covering the entire territory of Burundi and open to local investment and FDI; prescribes procedures for obtaining free enterprise status; foreign investors may create such companies or purchase their shares; establishes fiscal advantages, including a 10-year tax "holiday", exemption from taxes on dividends and from customs duties; allows free transfer of income and repatriation of capital; permits approved free enterprises to hold accounts in foreign currency without foreign exchange controls and to export without a licence; labour legislation is flexible.
Congo	Investment code of March 1992	Lifts most previous criteria to benefit from legal advantages it creates. Nationality of firms no longer a determinant to take part in privileged customs duty rates. Creates new tax breaks to promote investment in general and special tax incentives to firms operating in certain areas. Mandates the national investment commission to improve investment climate.
Egypt	<p>(a) Amendments to the Executive Regulations issues under Investment Law No. 230, issued by General Authority for Investment and Free Zones, of April 1992</p> <p>(b) Decree issued by General Authority for Investment and Free Zones, of April 1992.</p> <p>(c) Banking Law No. 37/1992, of 1 June 1992.</p>	<p>(a) Includes permission for foreign bank subsidiaries to operate in local currency; branch banks still limited to foreign currency transactions.</p> <p>(b) Further streamlines investment procedures applying to FDI; also, permits TNCs to form joint stock holding companies; allows repatriation of capital gains without prior approval of Investment Authority; opens new activities to FDI, including sea and air transport, as well as water and wastewater consulting services; reduces requirement of distribution of profits to employees.</p> <p>(c) Creates eight new investment zones open to both domestic companies and TNCs, two of which are free zones where companies are completely tax-exempt; in other zones, projects are exempt from taxes for 10 years from the commencement date of their activities.</p>

Table 4 (Cont'd)

Country	Law/Regulation	Content
Ethiopia	Proclamation No. 15/1992 to provide for the encouragement, expansion and coordination of investment, of 25 May 1992.	Aims at encouragement of FDI by opening some areas to private investment, while reserving some spheres to the Government and other spheres to Ethiopian investors; requires minimum FDI of \$500,000 with 25 per cent in cash deposits and registration of imported capital by foreign investors; establishes investment incentives in qualified areas, including partial exemption on custom duties and tax "holidays" for new investments and expansion of established ones; precludes nationalization except upon payment of adequate compensation; allows establishment of foreign currency accounts by investors earning foreign currency; allows remittances of dividends and payments and repatriation of capital in approved currency at prevailing rates; guarantees access to land use and water; establishes procedures for approval of investment applications and registration; requires registration of imported capital and approval of technology agreements.
Ghana	Amendment of the Investment Code of 1985, effective September 1992.	Removes previous restrictions to FDI, including requirement of Ghanaian participation in enterprises unless these were not foreign-exchange earners; reduction of minimum FDI equity participation for joint ventures and for wholly-owned foreign enterprises; reduces number of sectors closed to FDI from 24 to 2. Offers favoured treatment to investors in agriculture, manufacturing, tourism and construction.
Malawi	Investment Promotion Act, Act No. 28 of 1991, assented to by the President of 24 January 1992, effective 16 March 1992.	Establishes the Malawi Investment Promotion Agency, to encourage and facilitate both local investment and FDI, giving priority to certain sectors; permits FDI, with no ownership restrictions; replaces industrial licences with simple registration; plans assistance to develop industrial sites; states commitment to availability of foreign exchange, local financing and land; provides for tax and import duty incentives for export-oriented investment; states assurance of investment protection and access to international arbitration.

Table 4 (Cont'd)

Country	Law/Regulation	Content
Morocco	Offshore Financial Centres Law, Law No. 58-90, Dahir No. 1-91-131, of 26 February 1992.	Authorizes creation of offshore financial centre in Tangier, where non-resident banks are permitted to offer services to non-residents and to offer loans in convertible currency, without being subject to Moroccan banking laws; requires authorization by the Finance Minister; offers incentives for banks including exemptions from certain fees and charges for 15-year period, as well as corporation tax rate of only 10 per cent; even more liberal rules apply to offshore bank-holding companies.
Tunisia	Law 92-81, of 3 August 1992.	Authorizes creation of free zones within which companies, including TNCs, which export 100 per cent of their production benefit from a wide range of incentives, including tax relief, services, infrastructure and access to customs facilities.

Source: World Investment Report 1992 and 1993, Annex Table 11 and Annex Table 4 respectively.

Note: This list is indicative and not exhaustive.