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**ECONOMIC
DEVELOPMENT IN**

AFRICA

**REPORT 2014 CATALYSING INVESTMENT FOR
TRANSFORMATIVE GROWTH IN AFRICA**



UNITED NATIONS

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“No matter how long and winding
the road might be, it will always
lead you to your destination”

Proverb from Malawi

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EXPLANATORY NOTES

The \$ sign refers to the United States dollar.

Sub-Saharan Africa: Except where otherwise stated, this includes South Africa.

North Africa: In this publication, Sudan is classified as part of sub-Saharan Africa, not North Africa.

A hyphen (-) indicates that the data are either not available or not applicable.

ABBREVIATIONS

AfDB	African Development Bank
AGOA	African Growth and Opportunity Act
ECA	Economic Commission for Africa
EDAR	Economic Development in Africa Report
EITI	Extractive Industries Transparency Initiative
FDI	foreign direct investment
GFCF	gross fixed capital formation
GDP	gross domestic product
ICOR	incremental capital–output ratio
LDC	least developed country
MDG	Millennium Development Goal
NEPAD	New Partnership for Africa’s Development
ODA	official development assistance
PIDA	Programme for Infrastructure Development in Africa (African Union)
PPP	public–private partnership
SME	small and medium-sized enterprise
WTO	World Trade Organization

INTRODUCTION



MEETING AFRICA'S DEVELOPMENT CHALLENGES IN THE TWENTY-FIRST CENTURY

Africa has experienced high and continuous economic growth in the past decade, prompting analysts to argue that the continent has reached a turning point in its development history and is poised to play a more significant role in the global economy in the twenty-first century. The average annual growth rate of real output increased from 1.8 per cent in the period 1980–1989 to 2.6 per cent in 1990–2000 and 5.3 per cent in the period 2000–2010. Furthermore, 12 countries had an average growth rate above the developing-country average of 6.1 per cent over the period 2000–2010, and two countries (Angola and Equatorial Guinea) had double-digit growth rates. Unlike in the 1980s and 1990s, Africa's average growth rate since the turn of the millennium has also been higher than the average growth rate of the world economy (table 1). The continent experienced a significant slowdown in growth due to the global financial and economic crisis of 2008/2009 (Osakwe, 2010). Nevertheless, its average growth rate in the post-crisis period (2008–2012) was about 2 percentage points higher than that of the world economy. Internal and external factors contributed to Africa's relatively impressive growth performance over the past decade. Better macroeconomic management, high domestic demand and a relatively more stable political environment are some of the internal factors that supported growth in the continent. On the external front, favourable commodity prices, stronger economic cooperation with emerging economies, higher official development assistance since 2000, and an increase in foreign direct investment (FDI) flows contributed to the growth process.

Despite Africa's relatively strong economic growth performance over the past decade, many countries in the continent are grappling with several development challenges ranging from food insecurity, high unemployment, poverty and inequality, to commodity dependence, lack of economic transformation, environmental degradation, and low integration of the continent in the global economy. Since the dawn of the new millennium, African Governments and the international community have adopted various initiatives aimed at addressing these development challenges and improving living conditions on the continent. At the continental level, African Heads of State and Government adopted the New Partnership for Africa's Development (NEPAD), which emphasizes African ownership of the development process and outcome, and calls for interventions in the following priority areas: agriculture and food security, regional integration and infrastructure, climate change and environment, human development, economic governance, and capacity

development and women empowerment. At the international level, world leaders adopted the Millennium Development Goals (MDGs) which called for, among others, a halving of the proportion of people living in poverty by 2015. There are also ongoing efforts by the international community to delineate and finalize the broad contours of the post-2015 development agenda, within the framework of sustainable development.

While Africa has made some progress in achieving the goals set out in existing development frameworks, overall the continent is yet to realize the broad vision set out in these initiatives. For example, out of the eight MDGs, the continent is on track to achieve only three goals by the 2015 deadline, namely: achieving universal primary education (MDG 2), promoting gender equality and empowering women (MDG 3), and combating HIV/AIDS, tuberculosis and other diseases (MDG 6). Furthermore, the continent is still grappling with the problem of extreme hunger and poverty, and unemployment and inequality have increased over the past decade (United Nations Economic Commission for Africa (ECA) et al., 2013). These findings, based on analysis of macroeconomic data, have also been corroborated by the results of recent surveys. For example, a survey by Afrobarometer conducted in 34 African countries between October 2011 and June 2013 indicates that poverty rates in sub-Saharan Africa have gone down but that the number of people in poverty has increased despite a decade of relatively high growth. Reversing this trend is a challenge that African policymakers have to address effectively in the short to medium term to enhance the likelihood of achieving the African Union's vision of an integrated, prosperous and peaceful Africa.

Table 1. Average annual growth rates of real output (Percentage)

	1970–1980	1980–1989	1990–2000	2000–2010	2008–2012
World	3.80	3.26	2.82	2.77	1.65
Developing economies:	5.80	3.53	4.89	6.07	5.17
Africa	4.22	1.81	2.62	5.28	3.79
America	5.97	1.76	3.12	3.64	3.02
Asia	6.18	5.34	6.24	7.13	6.09
Eastern Asia	7.80	9.66	8.13	8.30	7.20
Oceania	2.86	3.79	2.38	2.87	3.41

Source: UNCTAD.

INVESTMENT, TRANSFORMATION AND DEVELOPMENT IN AFRICA

Research studies indicate that if Africa is to make significant progress in reducing poverty it will have to sustain average growth rates of about 7 per cent and above in the medium to long term, and this will require investment rates of 25 per cent of gross domestic product (GDP) and above (Clarke, 2013; ECA, 1999). Over the past two decades the average investment rate in Africa has hovered around 18 per cent, which is well below the 25 per cent threshold, and so it is not surprising that the continent has not achieved the 7 per cent average growth rate required to make significant progress in reducing poverty. This fact suggests that the slow progress in realizing Africa's development goals over the past decade is in part a consequence of the fact that the continent has not made the level of investments required to achieve these goals. In infrastructure, for example, it is estimated that countries in sub-Saharan Africa would need to invest \$93 billion per year in order to meet their development goals. But actual investment on the subcontinent is \$45 billion, implying a funding gap of about \$50 billion per year. The estimate does not include North Africa, so adding this region will increase the infrastructure funding gap for the continent significantly. There are also funding gaps in the production sectors and closing these gaps is a major challenge that African Governments will have to address in the short to medium term. This task will become even more daunting when the post-2015 development agenda is adopted because its implementation is likely to require additional investments and hence increase Africa's investment needs. In this context, one of the issues African countries have to address as they seek to transform their economies is how to boost investment, particularly in infrastructure and in the production sectors of the economy.

The nature and pattern of Africa's recent growth has also contributed to the slow progress in poverty reduction and in realizing the continent's other development goals (UNCTAD, 2012a). Africa's recent growth has not led to the development of productive capacities and structural transformation, which are two elements vital for generating productive employment and laying the foundation for sustained poverty reduction. Despite the continent's high and steady growth over the past decade, many countries are yet to go through the normal process of structural transformation characterized by a shift from low- to high-productivity activities, a decline in the share of agriculture in output and employment, and an increase in the share of manufacturing and modern services in output. The continent has

experienced deindustrialization in the past two decades as evidenced by the fact that the share of manufacturing in total value added fell from 13 per cent in 1990 to 12 per cent in 2000 and 10 per cent in 2011. Furthermore, the service sector is increasingly playing a key role in the growth process in Africa. In some countries this has been due to a boom in telecommunications activities. Nevertheless, for most countries in the continent, it is low-productivity activities such as informal and non-tradable services that account for the bulk of the recent boom in the services sector and so it is not surprising that it has not had the expected impact on economic transformation. The increasing importance of natural resources in the growth of African economies is also one of the reasons why recent growth has not had the desired impact on economic transformation. Because of the enclave nature of the resource sector, it cannot be relied upon to create enough jobs to absorb the 15 million youths who enter the labour market each year. In this context, there is the need to diversify the sources of growth to create employment, reduce vulnerabilities and also lay a more robust foundation for sustained growth.

African Governments have recognized the challenges posed by the current pattern of growth and have renewed their political commitment to economic transformation. At the continental level, economic transformation is one of the key priority issues in the draft strategic plan of the African Union entitled Agenda 2063. It is also one of the four priority issues identified by African countries in the African common position on the post-2015 development agenda. The other issues are innovation and technology transfer, human development, and financing and partnerships. At the national level, many countries have also made economic transformation a key focus of their development agenda in the medium to long term. For example, the Ethiopian Government has a Growth and Transformation Plan aimed at boosting agricultural and industrial growth. Cote d'Ivoire has an Economic Emergence Strategy aimed at making it an industrial economy by 2020. Similarly, Uganda intends to accelerate its socioeconomic transformation through Vision 2040 and Lesotho's Vision 2020 gives pride of place to industrial development. Countries such as Egypt, Kenya, Rwanda, Sierra Leone, South Africa, and Zimbabwe, among others, have also developed plans and strategies to transform the structure of their economies towards manufacturing and agro-related industries in the medium to long term. A key challenge facing these countries is how to translate their vision of economic transformation into reality. Clearly, this requires an understanding of the drivers of structural transformation in the development process. UNCTAD (2012a) identified investment and technology

as two key drivers of structural transformation. But investment rates in Africa are currently low relative to Africa's investment requirements and also relative to what is observed in other developing-country regions. Boosting investment is therefore of strategic importance in achieving the African development agenda. It is also imperative if the continent is to achieve sustained growth and be a pole of global growth in the twenty-first century.

While investment is important to the development process, it should be noted that it is a necessary and not a sufficient condition for economic transformation and sustained growth. In this regard, if African Governments want investment to play an effective role in supporting economic transformation and development, the focus should not be solely on boosting the quantity of investment to levels deemed necessary to meet national development goals. They also have to address two related issues. The first is how to ensure that investment is allocated to strategic or priority sectors, particularly infrastructure, agribusiness and manufacturing. Increasing investment and not allocating it to sectors crucial to achieving Africa's economic transformation agenda will be counterproductive. The second issue African Governments have to address is how to improve the quality or productivity of investment. This is important, particularly in the area of public investments, to avoid resource waste and achieve maximum impact. Low efficiency of public investments weakens the link between public and private capital and also reduces the returns to private investments, making it more challenging to attract such flows. Therefore, improving the productivity of investment should be part of efforts to boost investment and use it in support of economic transformation in Africa. There is also the need for investment in physical capital to be accompanied with complementary investments in human capital and technical knowledge to strengthen its developmental impact. Policy coherence at the national and international levels and the creation of an environment conducive to private sector development will also enhance the likelihood that investment will have a significant impact on growth and development.

MAIN FOCUS AND MESSAGES OF THE REPORT

Against this background, the *Economic Development in Africa Report 2014 (EDAR 2014)* subtitled *Catalysing Investment for Transformative Growth in Africa* examines how to boost and use investment in support of economic transformation and sustained growth in Africa. The term "investment" as used in the report refers

to total investment in the economy, which includes public and private investment. Private investment in turn consists of investment by local private investors and FDI. The focus of the report on total investment reflects the fact that all components of investment matter for growth and development and so the focus of policy should be on how to exploit the complementarities among the various components, rather than promoting one component at the expense of the other. Some of the key issues addressed in the report are as follows.

- What are the key determinants or drivers of investment in Africa?
- Are there similarities and differences in the composition and characteristics of investment across African countries? For example, which countries rely more on public investment relative to private investment and which group of countries rely more on domestic relative to external finance?
- How productive has investment in Africa been over the past two decades?
- How can investment be directed to strategic sectors of African economies to ensure that growth is accompanied by diversification and structural transformation?
- How can African countries strengthen linkages between investment by local and foreign firms?
- What policy measures are needed to catalyse investment for transformative growth in Africa?

The report provides actionable policy recommendations on how African countries could accelerate investment for transformative growth. The following paragraphs outline the key messages of the report.

First, achieving sustained and transformative growth in Africa requires broadening the sources of growth both on the demand and supply side of the economy. On the demand side, it requires balancing the relative contributions of consumption and investment to the growth process. While consumption is an important source of domestic demand and has been the dominant driver of growth in Africa over the past decade, it is evident that a consumption-based growth strategy cannot be sustained in the medium to long term because it often results in overdependence on imports of consumer goods, which presents challenges for the development and survival of local industries, the building of productive capacities, and employment creation. Furthermore, a consumption-based growth strategy has

to go hand in hand with an increase in investment, particularly those that increase the capacity to produce tradable goods, to reduce the likelihood and adjustment costs of current account imbalance reversals in the future. There is also the need to diversify the sources of growth on the supply side. And this will require a shift from low- to high-productivity activities both across and within sectors. It will also invariably require reducing the share of agriculture in GDP and increasing the shares of manufacturing and modern services.

The second message of the report is that enhancing the contribution of investment to growth requires boosting investment rates, improving the productivity of existing and new investments, and ensuring that investment goes to strategic and priority sectors deemed crucial for economic transformation. In this regard, the report underscores the need for African countries to lift the main binding constraints to investment in Africa. These include the poor state of infrastructure, lack of access to affordable finance, and risk and uncertainty. The report also suggests that African Governments should use industrial policy to direct investment to strategic production activities, such as agribusiness and manufacturing, which are critical for transformative growth.

A third message of the report is that more public investment, particularly in infrastructure, is needed to catalyse private investment in Africa. The policy bias against public investment in the 1980s led to a significant decline in public investment rates in many African countries and this had negative consequences on efforts to boost private investment. In this context, the report underscores the need for the focus of government policy to be on how to exploit the complementarities between public and private investments, rather than promoting one component at the expense of the other as has been the case in many countries on the continent.

The final message of the report is that African policymakers have to adopt a more coherent approach to promoting investment for it to play an effective role in driving economic transformation in Africa. In this regard, it underscores the need for macroeconomic and sectoral policies to be consistent with the objective of promoting investment. For example, the stance of monetary policy should be such that it does not lead to very high interest rates that hinder investment. The report also stresses the need for African Governments to ensure that policies to promote FDI do not discriminate against local investors and reduce entrepreneurship because a strong domestic private sector is the best way to attract FDI. Furthermore, it encourages the international community to make aid and trade more consistent with the objective of promoting investment in Africa. In the area of aid, this can be

accomplished by redirecting more of it towards stimulating investment through, for example, using aid as a guarantee mechanism to reduce risks faced by banks and investors. With regard to trade, coherence requires that the international community grant African countries more market access and policy space to promote trade and investment. It also requires that African countries adopt a more strategic approach to trade negotiations at the bilateral and multilateral levels to ensure that the outcomes are mutually supportive of their national development goals.

STRUCTURE OF THE REPORT

The main body of the report is organized as follows. Chapter 1 examines trends, patterns and other characteristics of investment in Africa, paying particular attention to similarities and differences across countries. It also provides some facts on the nature of recent growth and the link to economic transformation in Africa. Chapter 2 provides an assessment of the determinants of investment in Africa with a view to identifying the main constraints and factors inhibiting investment in the continent. Chapter 3 focuses on how to catalyse investment in Africa from a national and regional perspective, while chapter 4 examines selected international issues that have a bearing on efforts to boost and use investment for transformative growth in the continent. These include strengthening linkages between local and foreign enterprises, stemming capital flight to release more domestic resources for productive investment, and using aid and trade to catalyse investment. The last chapter discusses the main findings and policy recommendations of the report.

1

CHAPTER

INVESTMENT, GROWTH AND TRANSFORMATION IN AFRICA: SOME STYLIZED FACTS



This chapter provides an analysis of the trends, patterns, and other characteristics of investment in Africa. It also highlights differences in the characteristics of investment across countries and, where possible, discusses how they might explain observed economic performance between high- and low-growth countries on the continent. The chapter also presents more detailed information on the nature of Africa's recent growth and its implications for economic transformation on the continent. The aim is to establish some stylized facts on investment, growth and transformation that will form the basis for formulating policies to catalyse investment for transformative growth on the continent. The main facts emanating from the analyses are described in the following paragraphs.

Investment is a major determinant of long-run growth in Africa

In the growth and development literature, capital accumulation is regarded as a key determinant of an economy's long-run growth (Turnovsky, 2011). This strategic role of investment in the development process has been confirmed by recent empirical studies based on data for African countries. For example, using cross-country data, Mijiyawa (2013) finds that investment, credit to the private sector, government effectiveness, exports and the share of agricultural value added in GDP are significant growth determinants in Africa. Ghazanchyan and Stotsky (2013) also find some evidence that investment boosts growth in Africa. The cross-country evidence on the predominant role of investment for long-run growth has been supported by country-level analysis indicating that there is a positive association between investment and growth in African countries. In the case of South Africa, for example, Eyraud (2009) provides evidence linking investment to growth in South Africa (box 1). Fedderke et al. (2006) also find strong empirical evidence that investment in infrastructure is not only positively associated with economic growth, but that it actually leads growth. In sum, both the cross-country and country-level evidence indicates that investment is critical for accelerating growth in African economies.

There are structural problems with Africa's pattern of growth both on the demand and the supply side of the economy

On the demand side, the current pattern of growth has not been accompanied by significant improvements in investment rates (defined as the ratio of gross fixed capital formation (GFCF) to GDP) and as discussed earlier investment is one of the main determinants of an economy's long-run growth rate and productivity and so is crucial for achieving sustained growth and development. Over the past two

Box 1. Sluggish investment undermines growth in South Africa

The development experience of South Africa over the past few decades provides a good example of the link between growth and investment. The country has abundant human, financial and natural resources. It also has very good infrastructure compared to other countries on the continent. In the 1980s and 1990s the country had average growth rates of 1.4 and 2.1 per cent, respectively. Over the past decade, there has been a significant improvement in economic growth performance with an average growth rate of 3.9 per cent for the period 2000–2010. Nevertheless, this growth rate is still below those of fast-growing developing countries and, above all, it is well below the average growth rate of the continent, which was about 5.3 per cent over the same period. Investment ratios in South Africa have not changed very much over the past few decades. Over the period 1990–1999 the average investment ratio was 16.3 per cent and for the period 2000–2011 it was about 17.9 per cent, compared to the continental average of 18.7 per cent and the world average of 21.7 per cent. Eyraud (2009) presents evidence indicating that South Africa's investment rate is low compared to fast-growing developing countries and that sluggish investment undermines growth in the country. Furthermore, he argues that investment in South Africa has been constrained largely by low private savings due to structural factors such as the high dependency ratio and increased urbanization. High real interest rate has also been found to have a negative impact on investment in South Africa. In particular, when real interest rates increase by 1 percentage point, real investment growth falls by 7 percentage points after a year.

decades, the investment rate was either unchanged or declined in 28 countries on the continent. In Angola, for example, it fell from 28 per cent to 13 per cent between 1990–1999 and 2000–2011. In Eritrea, it fell from 25 per cent to 18 per cent and in Guinea-Bissau from 20 per cent to 10 per cent. At the continental level, the investment rate was 17.7 per cent in the period 1990–1999 and 18.7 per cent in the period 2000–2011. There was a marked increase in the average growth rate of investment in the period 2000–2011. However, output and other components of demand grew as well, and so the share of investment in GDP has not changed significantly over the past two decades. As shown in table 2, household consumption is the dominant component of demand in Africa. With an average growth rate of 5 per cent and a 62 per cent share of GDP, it made the largest contribution to output growth in the period 2000–2011.

Although consumption is an important source of domestic demand and has been the dominant driver of growth in Africa over the past decade, a consumption-based growth strategy cannot be sustained in the medium to long term because it often results in overdependence on imports of consumer goods, which presents challenges for the survival and growth of local industries, the building of productive capacities, and employment creation. Furthermore, it causes a deterioration of

the current account balance that would have to be corrected or reversed in the future to maintain external sustainability. Experience has shown that reversals of such current account imbalances often require drastic reductions in consumption that have a severe negative impact on growth. While investment booms can also deteriorate the current account, recent evidence suggests that current-account deficit reversals caused by investment booms that increase the production capacity for tradable goods are associated with better growth performance than those driven by consumption booms (Klemm, 2013). There is, therefore, the need to enhance the role of investment in the growth process, particularly given the very low investment rates observed in Africa relative to investment requirements.

There are also structural problems with Africa's recent growth from a supply or sectoral perspective. For example, it has not been transformative. Despite the fact that the continent has had high and steady growth over the past decade, many countries are yet to go through the normal process of structural transformation characterized by a shift from low- to high-productivity activities, as well as a declining share of agriculture in output and employment, and an increasing share of manufacturing and modern services in output. Available data indicate the share of manufacturing in total value added has declined over the past two decades. It fell from an average of 14 per cent for the period 1990–1999 to 11 per cent for the period 2000–2011. Furthermore, the service sector is now the most dominant sector of African economies. Its share of total value added in the period 2000–2011 was about 47 per cent, compared to 37 per cent for industry and 16 per cent for agriculture. In terms of dynamics, over the same period the service sector had an average growth rate of 5.2 per cent while agriculture had 5.1 per cent and industry 3.5 per cent (figure 1). Given the fact that the service sector has the highest growth

Table 2. Shares and growth rates of demand components in Africa, 1990–2011

	1990–1999		2000–2011	
	Share of GDP	Average growth	Share of GDP	Average growth
Household consumption	65.8	2.6	62.0	5.0
Government expenditure	16.5	2.1	15.1	5.3
Gross fixed capital formation	17.7	3.0	18.7	6.6
Exports	25.8	3.6	34.8	4.9
Imports	26.8	3.8	32.1	7.4

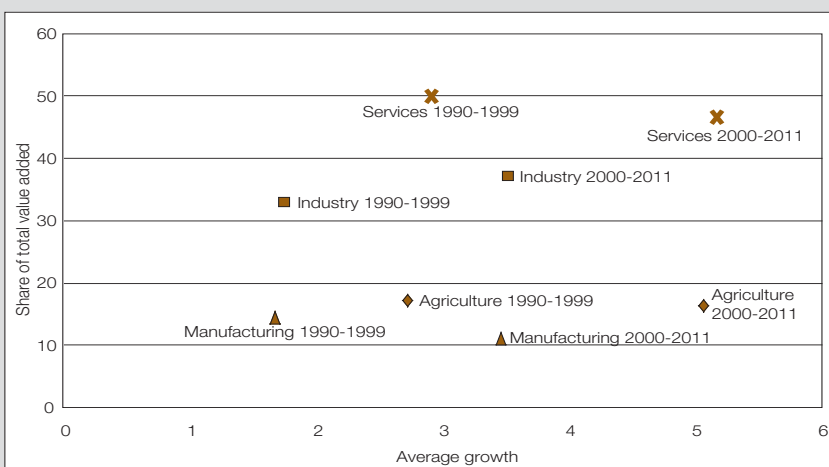
Source: UNCTAD.

rate and also has a higher share of total value added, its contribution to growth has been higher than those of other sectors. This pattern of structural change observed in Africa is quite different from what one would expect given the fact that the continent is still at an early stage of development. Usually, in the early stages of development the service sector does not play such a dominant role in an economy. Furthermore, the dominance of the service sector should be of concern because it is driven mostly by low-productivity activities such as informal and non-tradable services. These facts suggest that Africa's recent growth is fragile and is unlikely to be sustained in the medium to long term if current trends continue.

Africa has low investment rates relative to the average for developing countries and also relative to what is considered necessary to achieve development goals

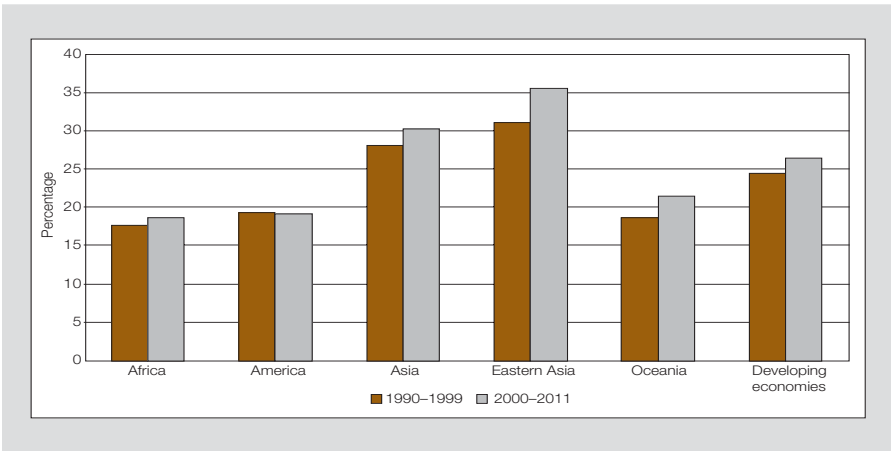
From a comparative perspective, Africa has low investment rates relative to the average for developing countries. On an annual average basis, the investment rate for Africa was about 18 per cent over the period 1990–1999 compared to 24 per cent for developing economies. Similarly, in the period 2000–2011, the average investment rate for Africa was about 19 per cent compared to 26 per cent for developing economies (figure 2). As shown in figure 3, Africa's investment rate over the past two decades has been consistently below those of developing countries.

Figure 1. Growth rates and shares of sectors in Africa's total value added, 1990–2011



Source: UNCTAD.

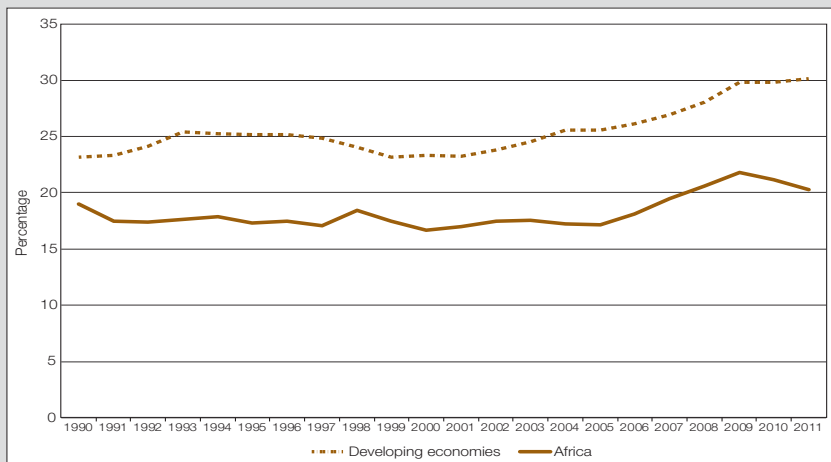
**Figure 2. Investment rates across developing-country groups
(Percentage of GDP)**



Source: UNCTAD.

The average investment rates for Africa described above hide substantial cross-country variation. High investment rates in the range of 25 per cent and above are rarely sustained in African countries. Over the past two decades, only a small set of countries in Africa have sustained investment rates of 25 per cent and above. These are Algeria, Botswana, Cape Verde, the Congo, Equatorial Guinea, Guinea, Lesotho, Sao Tome and Principe, and Seychelles. Equatorial Guinea exhibits unusually high investment rates with annual averages of 68 per cent for 1990–1999 and 43 per cent for 2000–2011. Low investment rates are especially prevalent in a broad range of African countries. For example, over the period 2000 to 2011, the following countries had average investment ratios below 15 per cent: Angola, the Central African Republic, the Comoros, Cote d'Ivoire, Guinea-Bissau, Liberia, Libya, Nigeria, Sierra Leone, Swaziland, and Zimbabwe.

Research studies also suggest that Africa's investment rates are lower than optimal levels in the sense that they are below what is needed to sustainably reduce poverty and achieve international development goals such as the MDGs. National as well as international development frameworks for developing countries have always emphasized the role of investment for stimulating growth, which in turn is viewed as a prerequisite for achieving the ultimate development goals of poverty reduction and other dimensions of social development. For example, one of the key targets under the Brussels Programme of Action for the Least Developed

Figure 3. Trends in gross fixed capital formation as a percentage of gross domestic product, 1990–2011

Source: UNCTAD.

Countries for the Decade 2001–2010 was to achieve an annual investment–GDP ratio of 25 per cent. Similarly, the Istanbul Programme of Action for the decade 2011–2020 considers an investment rate of 25 per cent necessary for achieving the target growth rate of 7 per cent in least developed countries (LDCs). Turning to the MDGs, research by ECA suggests that an investment rate of 33 per cent is required for African countries to be able to reach the growth rate of 7 per cent that was estimated to be necessary to meet the MDGs, especially the goal of reducing poverty by half by 2015 (ECA, 1999). Few African countries have been able to meet the Brussels Programme of Action/Istanbul Programme of Action targets on a consistent basis, let alone the ECA target. It should be noted that one of the reasons the target investment rates from both sources differ is that the estimate for LDCs includes non-African countries while that for the MDGs covers only African countries.

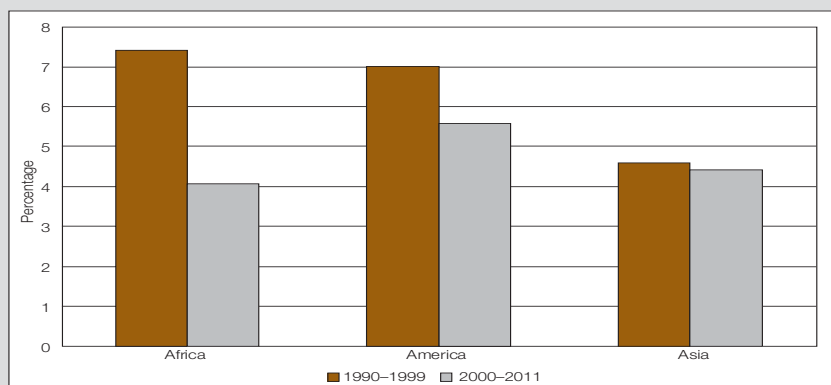
Africa experienced an increase in the productivity of capital over the past two decades

The discussion so far has focused on the quantity of investment. But the efficiency or productivity of investment also has an impact on an economy's growth

and development. To examine the extent to which capital has been productive in Africa, we have computed the incremental capital–output ratio (ICOR), which measures the degree of inefficiency in the use of capital in an economy. An economy with a higher ICOR has lower efficiency or productivity of capital. Figure 4 shows that in Africa the productivity of capital increased significantly between the two periods 1990–1999 and 2000–2011. In the period 1990–1999 the ICOR in Africa was about 7.4, while in the period 2000–2011 it fell to 4.1. Compared to other developing-country groups, over the period 2000–2011, the productivity of capital was much higher in Africa than in America and slightly higher than in Asia. This is a big change from the 1990s when the productivity of capital was lower in Africa than in the other developing-country groups.

Within Africa, there is a wide variation across countries in terms of the productivity of capital (table 3). If we compare the last two decades, some of the countries that have made significant progress in enhancing the productivity of capital include Angola, the Congo, Guinea-Bissau, Liberia, Sao Tome and Principe, and Zambia. However, the countries where capital had very high productivity in the period 2000–2011 were Angola, Equatorial Guinea, Ethiopia, Liberia, Mozambique, Nigeria, Rwanda, Sierra Leone, and the Sudan. While there has been a significant improvement in the productivity of capital at the aggregate level, it should be noted that there were 22 countries in the continent where the productivity of capital either

Figure 4. Incremental capital–output ratios across developing-country groups



Source: UNCTAD.

did not change or declined between the periods 1990–1999 and 2000–2011. Furthermore, there is some evidence indicating that public investment efficiency is low in sub-Saharan Africa (Dabla-Norris et al., 2011). The low efficiency of public investments in Africa tends to weaken the link between public and private capital. It also reduces the returns to private investments, making it more challenging to attract such flows. Therefore, although there has been an improvement in the efficiency of total investment in Africa, more work needs to be done, particularly in the area of public investments, to reduce waste and have maximum impact.

The composition of investment matters for growth in Africa

A relevant question to pose at this stage is whether the composition of investment matters in the investment-growth nexus. It is important to consider the composition of investment – that is, the distribution between private and public investment – for two main reasons. First, from a policy perspective it is helpful to know how to focus interventions aimed at boosting investment for stimulating growth. So, for example, conventional market-based economic reform policies promote a reduction in the role of the public sector in favour of private sector activity. Under that perspective, priority is given to private investment. The question then is whether the empirical evidence supports this view. In other words, is private investment more important than public investment in the growth process, or are both complementary? The second reason why it is important to consider the composition of investment is that if the distinction between public and private investment matters for growth, then there is the need to understand the linkages between them. Furthermore, if both types of investments are complementary, then from a policy perspective they are not mutually exclusive choices and so government efforts aimed at stimulating investment should accord attention to both types of investment.

The relative contributions of private and public investments to the growth process have been examined in the empirical literature, although most of the studies focus on developed countries. In general the evidence is mixed. Some studies find that public investment tends to crowd in (increase) private investment, while others find that it has a crowding-out effect. Nevertheless, studies based on African data do show that public investment has a positive effect on growth through raising the effectiveness of private investment. In other words, public and private investments are complementary. For example, Samake (2008) found that public investment crowds in private investment, and that both types of investment have a significant impact on growth in Benin. Similar evidence has also been provided for Cameroon (Ghura, 1997). Other studies have found that public capital is generally productive

Table 3. Incremental capital–output ratios in African countries, 1990–2011

	1990–1999	2000–2011
Algeria	16.31	7.45
Angola	17.58	1.26
Benin	3.32	5.00
Botswana	4.17	5.68
Burkina Faso	4.44	3.68
Burundi	-16.84	4.54
Cameroon	11.98	5.35
Cape Verde	6.19	6.39
Central African Republic	6.17	7.14
Chad	3.35	3.14
Comoros	10.99	5.62
Congo	34.77	6.6
Côte d'Ivoire	4.15	27.12
Democratic Republic of the Congo	-1.5	3.68
Djibouti	11.81	4.12
Egypt	3.95	3.81
Equatorial Guinea	3.2	2.46
Eritrea	3.16	35.5
Ethiopia	2.43	2.68
Gabon	8.44	11.59
Gambia	6.46	6.83
Ghana	3.28	3.13
Guinea	7.01	10.79
Guinea-Bissau	23.85	3.16
Kenya	7.11	4.69
Lesotho	14.22	7.6
Liberia	24.56	2.92
Libya	5.81	-9.14
Madagascar	7.6	7.94
Malawi	6.27	3.84
Mali	4.4	4.01
Mauritania	4.9	6.62
Mauritius	5.25	5.31
Morocco	8.38	6.16
Mozambique	3.16	2.69
Namibia	4.69	4.79

Table 3 (contd.)

	1990–1999	2000–2011
Niger	4.7	5.68
Nigeria	3.95	1.03
Rwanda	5.23	2.18
Sao Tome and Principe	34.65	5.59
Senegal	5.97	6.06
Seychelles	5.29	11.5
Sierra Leone	-1	1.61
Somalia	-7.24	6.94
South Africa	11.72	5.03
South Sudan		
Sudan	2.29	2.7
Swaziland	4.73	6.67
Togo	5.94	7.54
Tunisia	4.86	5.9
Uganda	2.3	3.02
United Republic of Tanzania	5.95	3.62
Zambia	42.17	4.05
Zimbabwe	1.58	-27.06

Source: UNCTAD; note that a higher incremental capital–output ratio implies lower productivity of capital.

and boosts output at the sectoral or national level. An example is the study on South Africa by Fedderke et al. (2006). Additional supportive empirical evidence on the role of public investments in the growth process in Africa can be found in Fosu et al. (2012). These findings confirm the strategic role of public investment in the growth process. It is practically difficult to imagine strong economic performance in Africa in the absence of the supply of adequate quantity and quality of infrastructure, and this is one area where public investment plays an important role.

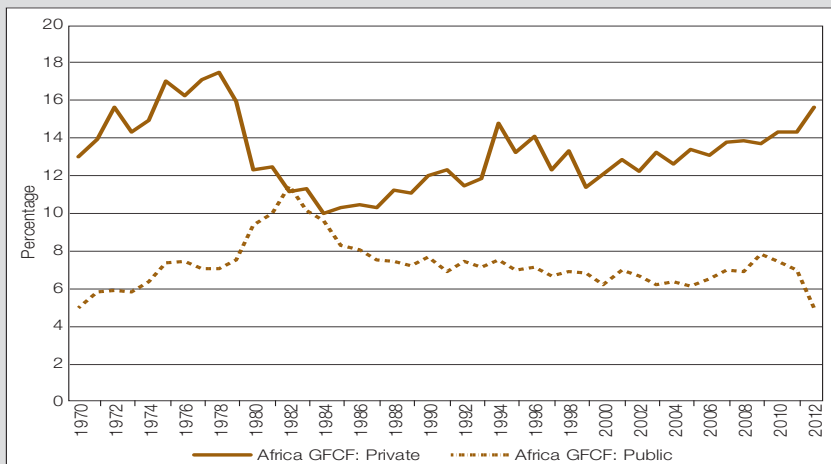
Public investment rates in Africa have declined relative to the 1980s and are currently below optimal levels

In analysing investment it is important to pay attention to its distribution into private and public investment. The long-term trends of investment in Africa show a dramatic decline in public investment since the beginning of the 1980s (figure 5). Following a steady rise from 1970 (5 per cent) to a peak of 11.5 per cent in 1982, public investment has since declined to about 5 per cent in 2012. Today,

public investment is at about half its peak level in the early 1980s. In the second half of the 1970s, public investment rose as private investment declined, and this trend was reversed in the early 1980s with public investment declining and private investment rising. While there was a significant decline in public investment in the 1980s, in the 1990s and 2000s it was relatively more stable at the continental level. The average public investment rate in Africa in the period 1990–1999 was 7.6 per cent and over the period 2000–2012 it was 7.5 per cent. However, these stable investment rates observed at the aggregate level mask the fact that many countries in the continent experienced a significant decline in public investment rates over the past two decades. Table 4 presents averages of public and private investment rates for the 1990s decade and the period 2000–2012 by country, as well as the contribution of each component to total investment. The evidence shows that there has been a decline in public investment rates in at least 23 countries over the past two decades, with the most dramatic declines observed in the following countries: in Cape Verde it fell from 18.1 per cent to 13 per cent; in Egypt it fell from 14.5 per cent to 8.2 per cent; in Eritrea the decline was from 17.6 per cent to 13.4 per cent; and in Lesotho the public investment rate fell from 18.2 per cent to 9.1 per cent.

It is important to uncover the causes behind the decline of public investment in Africa which began in the early 1980s. The timing of the decline is historically pertinent. It occurs during the period in which African countries were hit by the external debt crisis. As Governments ran out of financing while attempting to meet their debt obligations, it appears that public investment became the victim of the severe cuts in budgets that ensued. Thereafter, African countries underwent structural adjustment reforms which promoted a reduction in the role of the State and austerity. Therefore, the decline in public investment can be attributed to public expenditure compression mandated by debt distress and perpetuated by structural adjustment programmes. Table 4 shows that the degree of dependence on public investment varies widely across African countries. For example, over the period 2000–2012, the share of public investment in GFCF exceeded 50 per cent in Angola, Eritrea, Ethiopia, Guinea-Bissau, Libya, Mozambique and Rwanda. Furthermore, in the Central African Republic, Chad, Djibouti, Egypt, Ghana, Madagascar, Malawi, Niger, Sierra Leone, and Zambia, there was a significant shift in the composition of investment between the periods 1990–1999 and 2000–2012. In these countries there was a marked decline in the share of the public sector in investment, resulting in a higher share of the private sector.

Figure 5. Gross fixed capital formation in Africa – private and public (Percentage of GDP)



Source: World Development Indicators.

The general decline in public investment rates in Africa relative to the 1980s should be of concern to policymakers on the continent because recent studies suggest that public investment rates in Africa are below optimal levels. For example, Fosu et al. (2012) find that growth in African countries has been hampered by public “underinvestment” in the sense that actual public investment has remained below the optimal level required to reach high growth (or the growth-maximizing level of public investment). Simulations of growth models run by these authors show that the public investment rate that maximizes consumption is between 8.4 per cent and 11 per cent, depending on the discount rates used. However, the average public investment rate in Africa in the period 2000–2012 was about 7.5 per cent. The decline in public investment has important implications for growth prospects in African countries. Given the complementarity of public and private investment, the low rate of public investment erodes the potential impact of private investment on growth. This result is important for strategies to boost investment. It implies that the public sector has a crucial role to play in accelerating investment in Africa. While it is important for Governments to enact policies that incentivize private investment, it is clear that the first priority must be to substantially increase allocation to public investment.

Table 4. Shares of private and public sectors in gross fixed capital formation

	Period 1990–1999				Period 2000–2012			
	GFCF as % of GDP		Shares of total GFCF		GFCF as % of GDP		Shares of total GFCF	
<i>Country</i>	<i>Private</i>	<i>Public</i>	<i>Private</i>	<i>Public</i>	<i>Private</i>	<i>Public</i>	<i>Private</i>	<i>Public</i>
Algeria	19.0	7.3	72.2	27.8	12.3	11.4	51.9	48.1
Angola	16.6	6.7	71.2	28.8	3.9	8.9	30.5	69.5
Benin	10.6	4.9	68.4	31.6	11.2	8.2	57.7	42.3
Botswana	15.5	11.7	57.0	43.0	16.9	10.6	61.5	38.5
Burkina Faso	10.8	10.5	50.7	49.3	9.5	9.5	50.9	49.4
Burundi	-	-	-	-	7.7	6.6	53.8	46.2
Cameroon	11.7	2.9	80.1	19.9	14.3	3.1	82.2	17.8
Cape Verde	19.1	18.1	51.3	48.7	24.1	13.0	65.0	35.0
Central African Republic	5.0	6.2	44.6	55.4	6.1	4.3	58.7	41.3
Chad	4.3	7.4	36.8	63.2	20.2	9.1	68.9	31.1
Comoros	7.7	7.0	52.4	47.6	5.4	5.3	50.5	49.5
Congo	23.9	3.9	86.0	14.0	12.7	9.7	56.7	43.3
Cote d'Ivoire	6.2	5.2	54.4	45.6	7.2	2.8	72.0	28.0
Dem. Rep. of the Congo	6.3	1.7	78.8	21.3	11.6	3.8	75.3	24.7
Djibouti	5.8	6.1	48.7	51.3	11.9	6.6	64.3	35.7
Egypt	5.9	14.5	28.9	71.1	10.5	8.2	56.1	43.9
Equatorial Guinea	52.6	6.9	88.4	11.6	28.8	20.8	58.1	41.9
Eritrea	8.6	17.6	32.8	67.2	4.4	13.4	24.7	75.3
Ethiopia	9.9	6.6	60.0	40.0	7.9	15.1	34.3	65.7
Gabon	18.9	6.5	74.4	25.6	20.1	4.1	83.1	16.9
Gambia	14.9	7.4	66.8	33.2	12.9	7.7	62.6	37.4
Ghana	8.6	11.1	43.7	56.3	14.1	7.7	64.7	35.3
Guinea	12.0	7.9	60.3	39.7	13.5	4.4	75.4	24.6
Guinea-Bissau	7.7	18.3	29.6	70.4	1.1	10.9	9.2	90.8
Kenya	9.8	7.8	55.7	44.3	12.0	6.1	66.3	33.7
Lesotho	45.6	18.2	71.5	28.5	19.8	9.1	68.5	31.5
Liberia	-	-	-	-	12.5	4.2	74.9	25.1
Libya	-	-	-	-	3.2	14.9	17.7	82.3
Madagascar	5.5	6.9	44.4	55.6	16.9	7.3	69.8	30.2
Malawi	6.0	9.2	39.5	60.5	10.2	8.8	53.7	46.3
Mali	12.4	10.1	55.1	44.9	14.2	8.2	63.4	36.6
Mauritania	16.8	3.4	83.2	16.8	22	7.0	75.9	24.1
Mauritius	17.7	9.2	65.8	34.2	17.1	6.4	72.8	27.2

Table 4 (contd.)

	Period 1990–1999				Period 2000–2012			
	GFCF as % of GDP		Shares of total GFCF		GFCF as % of GDP		Shares of total GFCF	
Morocco	18.0	4.2	81.1	18.9	24.0	4.6	83.9	16.1
Mozambique	8.6	12.1	41.5	58.5	9.4	11.8	44.3	55.7
Namibia	12.8	8.2	61.0	39.0	16.3	4.5	78.4	21.6
Niger	3.3	5.7	36.7	63.3	16.5	6.3	72.4	27.6
Nigeria	16.9	4.0	80.9	19.1	8.1	5.5	59.6	40.4
Rwanda	6.8	7.3	48.2	51.8	8.6	9.0	48.9	51.1
Sao Tome and Principe	-	-	-	-	-	-	-	-
Senegal	15.4	4.5	77.4	22.6	18.2	8.5	68.2	31.8
Seychelles	-	-	-	-	-	-	-	-
Sierra Leone	2.9	3.9	42.6	57.4	8.2	5.2	61.2	38.8
Somalia	-	-	-	-	-	-	-	-
South Africa	13.5	2.8	82.8	17.2	12.5	5.4	69.8	30.2
Sudan	9.9	0.7	93.4	6.6	16.7	4.6	78.4	21.6
Swaziland	11.3	5.4	67.7	32.3	8.3	6.2	57.2	42.8
Togo	11.8	3.7	76.1	23.9	12.3	3.5	77.8	22.2
Tunisia	15.7	9.3	62.8	37.2	20.1	3.3	85.9	14.1
Uganda	10.3	5.6	64.8	35.2	16.1	5.5	74.5	25.5
United Rep. of Tanzania	15.6	6.0	72.2	27.8	19.5	6.4	75.3	24.7
Zambia	5.7	6.8	45.6	54.4	13.9	7.1	66.2	33.8
Zimbabwe	16	3.0	84.2	15.8	8.6	2.5	77.5	22.5
Africa average	12.7	7.6	62.6	37.4	13.4	7.5	64.1	35.9

Source: Computed based on data from *World Development Indicators*.
- = not available.

External finance continues to play an important role in financing investment in Africa but its contribution has declined significantly over the past two decades

African countries have historically used external finance such as FDI, debt, and official development assistance (ODA) to complement domestic resources for investment and this is evidenced by the fact that the continent has had a positive investment–savings gap over the past few decades. For example, in the period 1980–1989 the investment–savings gap of the continent as a percentage of GDP was 1.2 per cent. More recently, there has been a significant decrease in the gap. In particular, for the period 2000–2011, the continent had a negative investment–savings gap of about -2.8 per cent, reflecting the fact that more investment is

financed through domestic sources. To further explore the role of the source of financing investment in Africa, we look at the ratios of the traditional sources of finance to investment (box 2). We examine variations over time and across countries, highlight any differences between oil and non-oil African economies, and also discuss how African countries compare with other developing countries.

Table 5 presents the ratios of gross domestic saving, ODA, FDI, and external debt to investment, as well as the ratios of ODA and debt to public investment, and the ratio of private debt to private investment. First, the evidence in the table sheds some light on whether countries are able to finance investment with their domestic saving. The data show that African countries are able to cover a relatively smaller share of their investment through domestic finance compared to non-African developing countries. For the period 1970–2012, the ratio of domestic saving to investment is 48.4 per cent for Africa compared to 61.4 per cent for non-African developing countries. Over time, however, Africa has been able to close the gap. For the period 2000–2012, the ratio is 52.6 per cent for Africa compared to 59.9 per cent for other developing countries.

Oil-rich African countries exhibit a substantial surplus of saving over investment, with a ratio of 158 per cent for 2000–12. In contrast, non-oil-rich African economies have a low ratio of savings to investment. They had a ratio of 17.2 per cent over the same period. The ratio of savings to investment has increased substantially for

Box 2. The increasing role of remittances in Africa

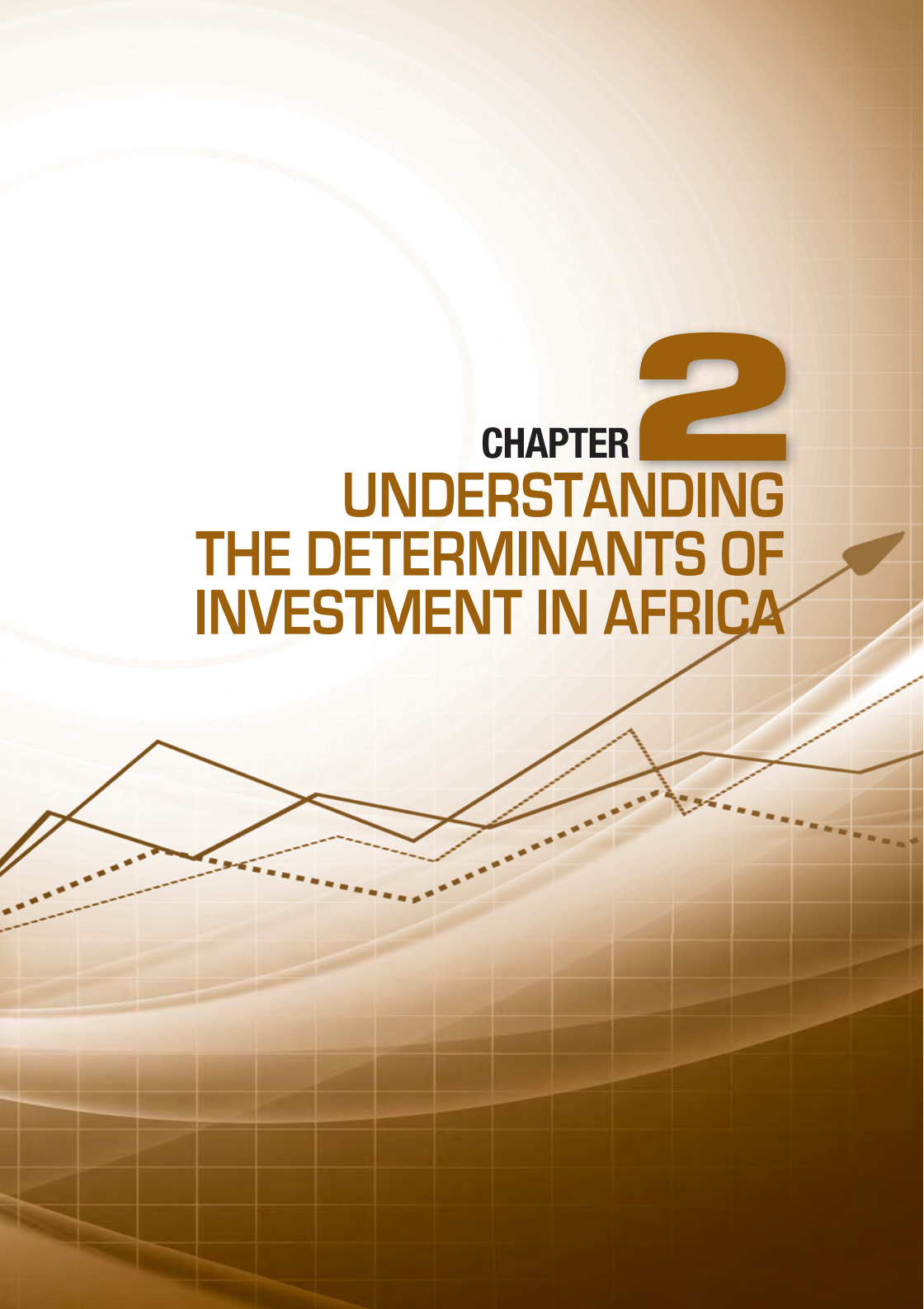
While FDI, ODA and debt have historically been the main sources of external finance in Africa, the importance of remittances has increased in recent years. In 1990, Africa received only about \$8.9 billion in remittances representing about 11 per cent of global flows and 26 per cent of flows to developing countries. However, in 2012 it is estimated that the continent received \$62.4 billion, which is 12 per cent of global flows and 17 per cent of flows to developing countries. Remittances are also attracting more attention from policymakers in Africa because they tend to be a less volatile source of finance than ODA and FDI, and as is well known, volatility has negative consequences for investment and output. Although remittances are often associated with brain drain, they also have a positive impact on development. In particular, they play an important role in poverty reduction and human capital development. Furthermore, available evidence suggests that contrary to the perception that remittances are only used to finance household consumption, they also have a significant effect on investment and saving (UNCTAD, 2012b). In a study on African countries, Baldé (2011), finds that although remittances may be quantitatively smaller than official aid in most countries, they have more positive impact on investment and saving, and consequently on growth. In this context, African countries should pay more attention to remittances as a potential source of stable and non-debt-generating finance.

Table 5. Selected sources of investment financing by categories of countries

Category	Domestic saving/ GCF	ODA/GCF	FDI/GCF	Debt/GCF	ODA/public investment	Net public debt/public investment	Net private debt/private investment
<i>Averages for the period 2000–2012</i>							
Non-oil Africa	17.2	78.0	24.0	620.4	251.4	22.0	2.2
Oil-rich Africa	158.8	34.9	27.8	449.9	202.7	-2.8	-3.3
Non-Africa	59.9	23.1	18.8	231.4	84.3	23.6	6.6
Africa	52.6	68.8	25.0	581.6	239.3	16.3	0.7
<i>Averages over the period 1970–2012</i>							
Non-oil Africa	27.6	81.2	11.5	541.9	225.7	42.8	0.4
Oil-rich Africa	110.1	35.3	15.5	547.1	171.7	30.1	-0.7
Non-Africa	61.4	25.5	12.4	249.0	88.0	34.8	4.8
Africa	48.4	70.7	12.5	543.2	211.2	39.6	0.0
<i>Source:</i> Computed based on data from <i>World Development Indicators</i> . GCF = gross capital formation.							

oil-rich countries, especially since the 1980s, spiking during oil boom episodes. African countries also depend on ODA to finance investment more than their other developing-country counterparts. The ratio of ODA to investment over the period 2000–2012 was 68.8 per cent for Africa compared to 23.1 per cent for other developing countries. The gap is even larger for public investment: 239.3 per cent for Africa compared to 84.3 per cent for other developing countries. However, African oil-rich countries appear to rely less on ODA, with a ratio of 34.9 per cent in the period 2000–2012 compared to 78 per cent for non-oil-rich countries. African countries also exhibit higher ratios of debt to gross capital formation compared to other developing countries. There are less distinguishing patterns regarding the FDI to investment ratio. Oil-rich countries exhibit slightly higher ratios, consistent with the tendency for resource seeking observed in FDI to African countries. It is important to note that the evidence presented in table 5 is only indicative of possible sources of financing for investment. So, for instance, high domestic saving does not necessarily imply correspondingly higher investment rates. While there can be a correlation between the level of saving and other forms of financing on one hand and investment on the other, it is not possible to infer causality. There are other factors that influence investment decision which may also influence the relationship between investment and these potential sources of financing for investment.



The background features a light brown grid pattern overlaid on a darker brown background. A large, bold, gold-colored number '2' is positioned in the upper right quadrant. Below it, the text 'CHAPTER' is written in a smaller, bold, black font. The main title, 'UNDERSTANDING THE DETERMINANTS OF INVESTMENT IN AFRICA', is written in a large, bold, gold-colored font across the center. In the lower half, there are several lines representing data trends: a solid gold line, a dashed gold line, and a solid black line, all showing various peaks and troughs. A white arrow with a gold tip points upwards and to the right, crossing the lines.

CHAPTER 2
**UNDERSTANDING
THE DETERMINANTS OF
INVESTMENT IN AFRICA**

Designing appropriate strategies for catalysing and stimulating investment in Africa requires a good understanding of the key determinants or drivers of investment in African countries. This would make it possible to tailor policy interventions to unlock specific constraints facing investment in given countries on the one hand and to harness the drivers of investment on the other hand. Evidence-based policy design also enables us to establish a hierarchy of interventions given that resources are limited and not all desirable interventions can be undertaken at the same time. It also permits us to determine the factors that can be influenced or mitigated by policy as opposed to those that are completely out of reach of the policymaker. Against this backdrop, this chapter identifies and discusses the key constraints and determinants of investment in Africa based on insights from economic theory as well as empirical work. For ease of exposition, we will discuss the constraints and determinants of investment in Africa under five categories: poor access to credit and the high cost of finance; low domestic savings; risk and uncertainty; inequality and the level of aggregate demand; and the policy and investment environment.

Access to credit and the cost of finance

Domestic investment by domestic enterprises is likely to be constrained by lack of access to credit as has been documented in several studies (Ajide and Lawanson, 2012). The private sector in Africa has very low access to financial resources for investment. In 2011 domestic credit to the private sector in Africa was about 62 per cent of GDP compared to a world average of 129 per cent and 75 per cent for low- and middle-income countries. Within Africa the share of domestic credit to the private sector in GDP is very low in many countries. For example, in 2011 it was 14 per cent in Algeria, 19 per cent in Burkina Faso, 15 per cent in Cameroon, 9 per cent in Equatorial Guinea, 15 per cent in Ghana, 9 per cent in Guinea, 12 per cent in Guinea-Bissau, 16 per cent in Liberia, 18 per cent in the United Republic of Tanzania and Uganda, and 12 per cent in Zambia. African firms also face very high costs of finance for investment which, as shown in empirical studies, constrains investment. For example, Bayraktar and Fofack (2007) find that the financing cost of investment, the public capital stock, and aggregate profitability shocks are important factors in estimating the growth rate of private investment in sub-Saharan Africa. The high lending rate charged by financial institutions in Africa is not conducive to the promotion of investment. Some of the countries on the continent with lending rates of more than 20 per cent in 2011 are: the Democratic Republic of the Congo (44 per cent), the Gambia (28 per cent), Madagascar (53 per cent), Malawi (24 per cent), Sao Tome and Principe (27 per cent), Sierra Leone (21 per cent) and Uganda (22 per cent). It should be noted that these rates are quite

high relative to those observed in the more successful developing countries. For example, in 2011 the lending rate in China was about 7 per cent, in India 10 per cent, and in Malaysia 5 per cent.

The degree of financial intermediation in an economy can also affect investment and it is well known that African countries have relatively low levels of financial intermediation as reflected in high interest rate spreads and margins. For example, in sub-Saharan Africa in 2011 the interest rate spread was 9 per cent compared to 5 per cent in East Asia and the Pacific, 6 per cent in South Asia, 7 per cent in Latin America and the Caribbean and 7 per cent in low- and middle-income countries. However, as shown in table 6, interest rate spreads can be very high in some countries (exceeding 15 per cent in 2009–2011 in countries such as the Democratic Republic of the Congo, Madagascar, Malawi, and Sao Tome and Principe, and exceeding 10 per cent in Angola, Liberia, Sierra Leone, the Gambia, Uganda and Zambia). A relevant question at this stage is why are interest rate spreads and margins high in Africa?

Several studies have been conducted on the determinants of interest rate spreads and margins in Africa. Using a sample of 456 banks in sub-Saharan Africa, Ahokpossi (2013) examined the determinants of bank interest margins in Africa. He found that interest margins are positively associated with market concentration and that bank-specific factors such as credit and liquidity risks are also important. Furthermore, interest margins were found to be sensitive to inflation. Folawewo and Tennant (2008) also find evidence that interest rate spreads are affected mostly by macroeconomic policy variables. At country level, there is evidence from Kenya that interest rate spreads increase after episodes of financial liberalization due to banks charging higher risk premiums on lending rates as their proportion of non-performing loans increases (Ngugi, 2001). For Namibia, Eita (2012) reports evidence that interest rate spreads for the period 1996–2010 were influenced by factors such as the treasury bill rate, inflation rate, size of the economy, financial deepening, bank or discount rate and exchange rate volatility. While hikes in treasury bill rate, inflation rate and bank rate could increase interest rate spreads, the size of the economy and financial deepening could decrease it. For Botswana, Ikhide and Yinusa (2012) report that financial deregulation and liberalization had failed to lower interest rate spreads. The costs of financial intermediation increased in Botswana between 1991 and 2007 due to balance-sheet factors, industry-specific and macroeconomic variables. Overall, their study finds that in the case of Botswana, interest rate spreads rose due to banks' high overhead costs, high equity or capital ratios, and a rise in banking concentration. According to the

Table 6. Interest rate spreads in Africa, 2000–2012

	2001–2004	2005–2008	2009–2011	2012
Algeria	3.43	6.20	6.25	6.25
Angola	58.39	21.57	10.11	13.33
Benin	..	..	..	..
Botswana	5.94	7.38	6.00	7.39
Burkina Faso	..	..	..	..
Burundi	..	..	..	..
Cameroon	13.67	11.50	..	..
Cape Verde	8.63	6.94	7.49	6.11
Central African Republic	13.67	11.50	..	..
Chad	13.67	11.50	..	..
Comoros	8.42	8.00	5.31	8.75
Congo	13.67	11.50	..	..
Cote d'Ivoire	..	..	..	..
Democratic Republic of Congo	..	33.99	39.83	20.73
Djibouti	9.91	9.26	9.39	..
Egypt	4.81	6.16	4.85	4.36
Equatorial Guinea	13.67	11.50	..	..
Eritrea	..	..	..	..
Ethiopia	4.25	3.42	..	..
Gabon	13.67	11.50	..	..
Gambia	12.55	15.96	13.38	16.50
Ghana	..	..	..	..
Guinea	..	..	..	..
Guinea-Bissau	..	..	..	..
Kenya	12.13	8.30	9.36	8.15
Lesotho	10.66	7.90	7.81	7.27
Liberia	14.05	11.83	10.50	10.02
Libya	4.00	3.71	3.50	3.50
Madagascar	12.39	19.36	37.95	49.50
Malawi	22.64	21.73	20.80	21.25
Mali	..	..	..	..
Mauritius	11.69	9.22	1.05	2.43
Mauritania	13.38	14.73	9.83	11.19
Mozambique	10.29	8.71	6.28	5.38
Morocco	8.37	7.98	..	..
Namibia	6.19	4.99	4.68	4.44

Table 6 (contd.)

	2001–2004	2005–2008	2009–2011	2012
Niger	..	..	..	..
Nigeria	7.07	6.18	8.82	8.39
Sao Tome and Principe	20.70	19.20	17.18	13.28
Senegal	..	..	..	..
Seychelles	6.11	7.33	8.18	8.89
Sierra Leone	12.63	13.44	11.64	10.61
Somalia	..	..	..	..
South Africa	4.83	4.03	3.29	3.31
South Sudan	..	..	..	..
Sudan	..	..	..	..
Swaziland	7.01	6.41	6.01	6.29
Togo	..	..	..	..
Tunisia	..	..	..	..
Uganda	12.42	10.02	10.83	10.08
United Republic of Tanzania	12.44	8.39	7.74	5.95
Zambia	20.63	13.01	13.43	5.15
Zimbabwe	69.82	298.38	..	..
Simple average	13.65	18.46	10.73	10.31

Source: World Development Indicators.

authors, in Botswana, South Africa and Namibia, banks have to incur additional costs to gather information about the credit worthiness of new borrowers and such an activity raises the transaction costs of banks. The small size of the Botswana economy also accounts for banks' higher operating costs.

While further research is warranted on the determinants of interest rate spreads in African countries and the link to availability of credit to investors, the above empirical studies suggest that the high costs of finance and the low levels of financial intermediation act as a brake on investment. Policies to reduce the cost of credit to investors should incorporate measures to reduce the costs of financial intermediation and increase the efficiency of the African banking sector.

Low domestic savings

Investment can be financed through both domestic and external sources. However, given the challenges facing African countries in accessing external finance, they tend to rely more on domestic sources for investment. But Africa generally has low savings ratios relative to investment requirements and also relative to what is

observed in other continents. In 2012 the savings ratio was 17.7 per cent in sub-Saharan Africa compared to 30.4 per cent in low- and middle-income countries, 25.2 per cent in South Asia and 22.3 per cent in Latin America and the Caribbean. Some of the reasons for low savings rates in Africa include the existence of a large informal sector, a low income level, a low level of financial development, a low tax base, and weak tax and customs administration.

Domestic saving plays a crucial role in financing public investment, especially in African countries with very limited access to external capital markets. With regard to private investment, it is important to the extent that it enhances credit to the private sector. A higher savings rate does not necessarily translate into higher credit to the private sector, which is an important determinant of private investment. Therefore, although domestic savings can in principle contribute to private investment the realization of this benefit is not automatic. In particular, if domestic savings are hoarded in liquid and unproductive assets rather than being properly intermediated and extended as credit to the private sector, it is unlikely to play a direct role in capital accumulation in the private sector. Nevertheless, to the extent that domestic savings enhance public investment, which increases the productivity of private capital, it can also have an indirect impact on private investment.

Risk and uncertainty

Investment decisions are also affected by risk and uncertainty arising, for example, from political instability, macroeconomic volatility and policy reversals. Uncertainty raises the transaction and adjustment costs associated with investments. In the presence of uncertainty and given the irreversibility of investment decisions, investors may choose to forgo or delay investment to avoid bearing the cost of investing in the wrong activity (Dixit and Pindyck, 1994). According to the June 2012 *International Country Risk Guide* overall risk ratings (based on an aggregate of political, financial and economic risks), there were 21 African countries among the 40 riskiest countries in the world, with the five riskiest countries all located in Africa. Such risks, whether perceived or real, lower incentives for entrepreneurs to invest. Bayraktar and Fofack (2007) find that uncertainty in the form of macroeconomic volatility is a significant determinant of private investment in Africa. At the country level, Gnansounou (2010) finds that demand uncertainty has a negative effect on investment by private firms in Benin. He argues that firms in Benin have to compete with products imported from neighbouring countries such as Nigeria, Côte d'Ivoire and Ghana. The ready availability of imported products on the Beninese markets, competing with locally manufactured goods, reduces the market share of local

firms and makes their residual demand uncertain, especially given fluctuations in external/imported supply.

There is also country-level evidence from other African countries linking uncertainty to investment. For example, Leefmans (2011) uses firm-level panel data to investigate the extent to which uncertainty faced by firms affects manufacturing investment in the United Republic of Tanzania. The results show that uncertainty has a negative impact on investment, particularly by medium and large firms. Furthermore, the results indicate that the impact of uncertainty is less when firms have the possibility to reverse their investment decisions, indicating that irreversibility of investment decisions matter for investment. Zeufack (1997) has also provided evidence, using firm-level data, linking demand uncertainty to investment behaviour of local and foreign private firms in Cameroon over the period 1988/89 to 1991/92. The study found that demand uncertainty negatively affected investment. Other significant determinants of investment in the study include lagged capital stock and profitability. In a more recent study, Khan (2011) investigates the impact of resource inflow (export revenue, FDI, official flows, other private flows) volatility on domestic investment in Cameroon for the period 1970–2000. His results showed that resource inflows and their volatilities matter for private and public investment. Export revenue instability and volatility in private flows significantly undermined private investment, while official flows and FDI did not. Furthermore, credit to the private sector promoted private investment while debt overhang reduced it. There is also evidence that resource inflow volatility, government consumption and debt overhang undermine public investment. These findings underscore the need for African Governments to strengthen efforts to reduce risk and uncertainty associated with investment.

Inequality and aggregate demand

The distribution of income in an economy can affect investment. For example, high inequality often leads to social and political conflicts which create insecurity over property rights thereby increasing uncertainty and undermining investment. Inequality in wealth and status can also impact on the quantity and quality of investment due mostly to imperfections in credit, insurance and land markets (Banerjee, 2004). Richer people tend to face better access to credit, have better access to collateral and thus tend to invest more relative to the poor, although such investments tend not to be among the most productive. Furthermore, when deposit rates are low compared to lending rates, it implies that the opportunity cost of capital for those who have their own funds (the rich) is lower than for those

who need to borrow (the poor). In this context, a redistribution of income from the wealthy to the less wealthy, accompanied by policies to address imperfections in assets and financial markets can thus expand the volume and range of productive investments in the economy.

There is also the view that “aggregate consumption and the incentive for private firms to undertake fixed investment are greater when a given national income is distributed more equally, because lower income groups spend a larger portion of their income on consumption than higher income groups” and this in turn stimulates expected aggregate demand and expected profits for firms (UNCTAD, 2012c). As Keynes argued, in situations of high or rising unemployment, a higher marginal propensity to consume can actually be accompanied by a higher inducement to invest. In an African context, given the high income inequality prevailing and the levels of unemployment, a reduction in income inequality can actually contribute towards raising both the marginal propensity to consume and the marginal propensity to invest. That is, a reduction in income inequality raises aggregate output both through higher levels of consumption and higher levels of investment.

Despite the potential link between inequality and investment, there are very few studies that have attempted to provide evidence on the relationship using African data. The only study that we are aware of in this regard is the paper by Heintz (2000). This author investigated the link between distribution, investment and employment in South Africa and found that unequal distributions of income and assets contribute to social conflicts and depress the rate of investment. He also found that the rate of after-tax profit has a large impact on investment in South Africa. The results suggest that policies to boost investment in Africa must address issues pertaining to income and asset distribution.

Policy and investment environment

The domestic policy and investment environment affects the competitiveness of firms and hence is an important determinant of investment (box 3). African countries continue to figure among the least competitive economies in the world. As was noted in the *Africa Competitiveness Report 2013*, 14 out of the 20 least-competitive countries on the Global Competitiveness Index are in Africa, and Africa as a whole trails behind South East Asia, and Latin America and the Caribbean in terms of competitiveness, with the greatest gap being in areas such as quality of institutions, infrastructure, macroeconomic stability, education and information and communications technologies (World Economic Forum, 2013). The poor

competitiveness of most African countries is undoubtedly a serious impediment to the promotion of investment in Africa. Poor infrastructure, high transactions cost associated with starting and operating a business, and weak enforcement of contracts are some of the factors that have contributed to the low levels of competitiveness of African economies. It is estimated that weak infrastructure reduces the productivity of companies in Africa by 40 per cent and growth of per capita income by 2 per cent.

How is poor domestic competitiveness related to low investment? A first channel lies in the impact of domestic competitiveness on the incentives to invest by local and foreign investors due to its effect on the expected returns to investment. In deciding to invest or not, an investor needs to compare the costs of undertaking his/her investment to the expected returns from the investment over a given period of time. The costlier it is to invest due to a weak competitive environment, the higher the rate of return on the investment needs to be in order for investment to be profitable. This requirement for higher returns limits the range and scale of investment opportunities available to firms. In addition, domestic consumer markets in Africa tend to be small in size, limited by low levels of household disposable incomes, a narrow productive base, and a large prevalent informal sector, all of which are factors that constrain the rate of returns from investment and economic activity. A second link between poor domestic competitiveness and low investment is through an imports channel. African domestic firms have to compete against more competitive imported products. As the study on Benin demonstrates, an influx of cheaper, highly competitive imports from abroad can restrain demand for locally made African products and introduce uncertainty in the demand functions of African firms, blunting their incentives to undertake investment (Gnansounou, 2010).

A third channel linking poor domestic competitiveness to low investment is the impact of poor domestic competitiveness on levels and composition of FDI. FDI inflows into Africa are affected by a range of factors that include competitiveness factors such as the ease of doing business and natural endowments such as primary resources (UNCTAD, 2009a; Anyanwu, 2012). In the absence of a strongly competitive business environment allied with a strong private sector, it can be argued that FDI in Africa gets pulled in mostly by its location-specific advantages, in turn driven by its natural resources, dominated by oil. The absence of diversified national economies, marked by weak industrial bases, coupled with low levels of competitiveness, constrain the African continent to receiving FDI

inflows predominantly in extractive industries that have weak linkages with the rest of the economy. Consequently, Africa's share of global FDI continues to remain low and is composed mainly of resource-seeking inflows over market-seeking and efficiency-seeking inflows. Investment in Africa could be increased if countries were to implement policies aimed at boosting competitiveness and strengthening the private sector while continuing efforts at accelerating industrialization and economic transformation.


Box 3. Investment, growth and economic policy in Rwanda

Rwanda is one of the 10 African countries that have had very impressive economic growth performance over the past decade. Its average growth rate increased from 0.14 per cent in the period 1990–2000 to 8.1 per cent over the period 2000–2010. Capital accumulation played an important role in this growth turnaround. The average investment ratio rose from 11 per cent in the period 1990–1999 to 17 per cent in the period 2000–2011. While its average investment ratio is below the 25 per cent threshold, it is trending upwards and so is less worrisome than is the case in some African countries. In fact, if the upward trend in investment ratio continues, Rwanda has good prospects of sustaining its recent growth in the medium to long term. Government efforts aimed at strengthening the private sector have played an important role in the significant increase in investment ratios observed in Rwanda over the past two decades. At the beginning of the new millennium, the Government unveiled a new economic development strategy, entitled Vision 2020, aimed at transforming Rwanda into a middle-income and diversified economy by 2020. The vision was anchored on six pillars, namely:


- Transformation of agriculture into a productive, high-value, market-oriented sector, with forward linkages to other sectors;
- Development of an efficient private sector spearheaded by competitiveness and entrepreneurship;
- Comprehensive human resources development;
- Infrastructural development;
- Reconstruction of the nation and its social capital anchored on good governance, underpinned by a capable State;
- Promotion of regional economic integration and cooperation.

The Government introduced reforms to promote entrepreneurship, create a dynamic and competitive private sector, and enhance the likelihood of achieving the goals of Vision 2020. It improved the efficiency of public investment management, strengthened dialogue with the private sector, made it easier for firms to access credit and simplified the tax system. It also maintained political stability and reduced the number of days it takes to start a business to one day (compared to an average of 45 days for the continent in 2011). These and other related measures have made Rwanda an attractive place for both local and foreign investment.

Source: UNCTAD and www.rdb.rw/about-rwanda/economy.html (accessed 19 March 2014).



CHAPTER **3**
**POLICIES FOR CATALYSING
INVESTMENT IN AFRICA:
NATIONAL AND
REGIONAL ASPECTS**



This chapter discusses policies that are necessary at the national and regional levels to catalyse investment for transformative growth in Africa. It draws on the empirical facts and challenges to boosting investment in Africa discussed in the previous two chapters. It underscores the fact that catalysing investment to achieve high, sustained and transformative growth in Africa requires boosting the quantity of investment, ensuring that it goes to strategic or priority sectors of an economy, and improving the productivity or quality of that investment. Most discussions on investment in Africa tend to focus on the quantity issue. However, the historical experiences of developed and emerging economies suggest that enhancing the quality of investment and ensuring that it goes to productive and strategic sectors are also necessary to maximize its impact in an economy. Against this background the policy recommendations discussed in this chapter will be organized around the following three areas: increasing the level and rate of investment; ensuring that investment goes to priority sectors; and improving the productivity or quality of investment.

A. BOOSTING THE LEVEL AND RATE OF INVESTMENT

A balanced and coherent approach to macroeconomic policy is needed

Increasing investment in African countries on a sustained basis will require a rethinking of the traditional macroeconomic policy framework and reorientation of its goals in a substantive fashion. Macroeconomic policy in developing countries in general and in African countries in particular has typically pursued two very narrow goals, namely maintaining price stability and sustainability of public debt. Under this framework, the primary focus of monetary policy has been on containing domestic demand through high interest rates. The consequence of this policy orientation has been a high cost of capital, which depresses domestic lending and reduces incentives for investment. While there is the need for price stability in an economy, it is important that this goal is not achieved at the expense of other national development objectives. In this regard, the traditional approach to macroeconomic policy is inconsistent with the objective of promoting investment for transformative growth and needs to be changed. With regard to fiscal policy, the conventional policy stance followed by African countries also undermines investment. More often than not the focus of fiscal policy has been on reducing public sector deficits – even in periods of slow growth where an increase in government expenditure is needed to stimulate demand and output. Furthermore, fiscal policy has been

characterized by an inefficient allocation of public spending to the detriment of infrastructure investment and maintenance. This results in both low expansion of the stock of public infrastructure as well as poor quality of infrastructure, with dire consequences for private investment.

Under the standard macroeconomic policy framework, investment expansion is considered inflationary, reflecting a focus on the demand side of the economy. However, investment is needed to increase the economy's productive capacity, create jobs and sustain growth. While an increase in investment may be associated with a short-run increase in the general price level, the inflationary effects are likely to be minimal in the medium to long run. As a result, a growth strategy driven by investment expansion is likely to exhibit a stable combination of high growth and moderate but stable inflation. In contrast, contractionary monetary and fiscal policy focused on aggregate demand compression is likely to lead to low inflation but also low investment and low growth. The losses in investment and growth may be an exorbitant cost to pay for African countries that need to accelerate growth in order to enhance the likelihood of achieving their development goals. In this context, there is the need for a more balanced and coherent approach to macroeconomic policy in Africa than has been the case in the past to create much-needed space for investment expansion. One way to accomplish this is to adopt a discriminating treatment of domestic demand that distinguishes between consumption and investment expenditures and gives priority to the latter. When Governments face resource shortages and are pressured to compress expenditures, the primary victim is usually public investment. However, strong public investment is a prerequisite for strong private investment. Boosting public investment should therefore be a central element of an effective strategy to stimulate investment in Africa.

Reverse the policy bias against public investment

Since the 1980s, efforts to stimulate investment have focused on private investment in the context of market-centred economic reforms. Thus, Governments have been advised to focus on policies that were expected to create an environment conducive to private sector activity. While private investment plays an important role in the growth process and should be promoted, the market-centred approach adopted in the 1980s implicitly assumes that private investment takes place in a vacuum. In particular, it ignores the fact that private investment and public investment are complementary. As public investment primarily consists of public infrastructure, low performance of public investment has substantial negative spillover effects on the private sector. Inadequate provision of public infrastructure increases the

private costs of production and trade, which undermine the competitiveness of the private sector and reduce the incentives to invest. Available evidence indicates that high transportation costs constitute a major impediment to African countries' ability to competitively penetrate global markets (African Development Bank (AfDB), 2010; Naudé and Matthee, 2007). High transportation costs also inhibit African countries from trading with each other. For example, one study estimated that regional trade could increase by \$10 billion to \$30 billion per year if the road connections between the Central African Republic and the Democratic Republic of the Congo were upgraded (Buys et al., 2006).

There is the presumption that expansion of public investment implies expansion of the public sector, and that this is inherently bad for the development of the private sector and long-run growth. This view of investment policy has done much damage to developing countries and needs to be changed. The policy bias against public investment is largely responsible for the significant decline in public investment rates observed in Africa beginning in the early 1980s. Raising public investment should be a key element of any strategy to increase domestic investment in African countries. It is also fundamental to the success of efforts to facilitate integration in the global markets and to stimulate intraregional trade in Africa. Bringing public investment to the centre of the investment promotion strategy will require commitment of Governments to both securing adequate budgetary allocations for new public investment as well as provisions for maintenance of public infrastructure. It will also require exploiting potential synergies between public financing and private financing, notably through public–private partnerships (PPPs) in large infrastructure investment projects.

Strengthen domestic resource mobilization

Enhancing mobilization of domestic resources is needed to create more policy space for African Governments to finance public investments needed to catalyse and sustain private investments. Although there has been an increase in domestic revenue in Africa from \$142 billion in 2002 to \$580 billion in 2012, the majority of African countries have performed below their potential in terms of domestic revenue mobilization. This is a result of many factors, including a narrow tax base, inefficiencies in tax collection, the existence of a large informal sector, and weak governance. There is the need for Governments to broaden the tax base by exploiting the potential for increasing government revenue through, for example, property and environmental taxes (UNCTAD, 2009b). Outsourcing of tax collection to semi-autonomous institutions can also help to improve tax administration as has

been the case in Malawi, Rwanda, the United Republic of Tanzania, Uganda, South Africa and Zambia (NEPAD and ECA, 2013). Governments should also promote private savings through developing and strengthening the financial system. Better management and use of natural resource wealth will also enhance domestic resource mobilization in Africa. In this regard, there is the need for African Governments to ensure that there is transparency and domestic accountability in the use of natural resource rents through, perhaps, the setting up of an independent committee to monitor and verify information on the use and management of resource rent. The committee should be required to present its report to parliament once each year. African Governments should also consider earmarking a fixed percentage of natural resource rent annually for development and maintenance of infrastructure. The goal should be to fill gaps in public infrastructure in key areas such as power generation and transmission, transportation, and water.

Improve financial intermediation and enhance access to affordable credit

The development of the financial system is critical to boosting investment in African countries. At the moment, financial systems in Africa exhibit a number of structural deficiencies that limit their ability to mobilize savings and channel it into productive investments. First, financial systems in Africa are dominated by banks, which are relatively small and concentrated compared to those on other continents. Many of these banks are also foreign owned and tend to lend mostly to large firms rather than small and medium-scale entrepreneurs. Empirical studies have found a negative association between foreign bank presence and private credit in poor countries, indicating that the ownership structure of banks has implications for private sector credit in developing countries (Detragiache et al., 2006). Banks in Africa also tend to hold excess liquid reserves in the form of government securities, rather than lend to the private sector for productive investments. This is due in part to perceived risks of borrower default, and also for precautionary motives, such as the need to safeguard against unexpected withdrawals. However, policy incoherence also plays a role in the fact that banks prefer to hold government securities. While African Governments encourage banks to lend to the private sector, the interest rate on government bonds is often so high that banks have no incentive to lend to the private sector. In Nigeria, for example, the interest rate on government bonds is often as high as 12 per cent, creating an incentive for banks to hold government instruments rather than lend to the production sectors. This underscores the need for more coherent policies at the national level to promote lending to the private sector. One way to compel banks to lend to the private sector is to reduce excess

reserves in the financial system by imposing taxes on reserves. The provision of partial guarantees by the State to commercial banks to encourage them to lend to entrepreneurs for investment in strategic activities can also contribute to reducing excess reserve holdings.

Reducing information asymmetry between borrowers and lenders is crucial for enhancing access to credit and African Governments can do this through strengthening support for the establishment of private credit bureaux, public credit registries, and movable collateral registries (box 4). A recent study found that the introduction of collateral registries for movable assets increases firms' access to finance and that the impact is larger among smaller firms (Love et al., 2013). There is the need for African Governments to promote the establishment of such registries to enhance access to finance. So far, only Ghana, Kenya, Mauritius, Nigeria, Rwanda, Seychelles, South Africa and the United Republic of Tanzania have movable collateral registries in sub-Saharan Africa. Other measures to enhance access to credit for African entrepreneurs include deepening the financial sector in Africa and stimulating competition within the banking sector and between the banking and non-banking financial sector to expand on the range of alternative sources of credit available to African investors. There is also the need to accelerate efforts towards regional integration and regional trade in financial services in order to create larger consumer markets for African banks as part of promoting efficiency in the African banking sector.

A second structural deficiency of the financial system in Africa is that credit is very expensive, as evidenced by high lending rates and non-interest costs such

Box 4. Reducing information asymmetry between borrowers and lenders in Kenya

The Kenyan Government has strengthened efforts to improve bank credit to the private sector through the reduction of information asymmetry between borrowers and lenders. In July 2010, it launched a credit information sharing system to be used by banks and individuals. There are two licensed credit reference bureaux in Kenya charged with the responsibility of collecting, managing and disseminating customer information to lenders. In 2013, a new credit reference bureau regulation was announced requiring institutions licensed under the Banking Act and the Microfinance Act to share credit information through licensed credit reference bureaux. These regulations and the credit information sharing system are expected to strengthen credit appraisal standards, reduce the need for collateral-based lending, inculcate credit discipline in borrowers, and enhance access to credit to the private sector.

Source: Central Bank of Kenya.

as collateral requirements and loan origination fees. To alleviate this constraint, African countries need to consider a reorientation of macroeconomic policy towards investment promotion as discussed earlier. Thus, monetary policy should be designed to keep interest rates at levels that do not discourage investment. This requires a balanced approach to monetary policy that embraces price stability as well as growth as primary objectives. It also requires better monitoring and regulation of the financial sector to ensure that lending interest rates and spreads charged by financial institutions reflect more accurately the costs and risks they face. Central banks in Africa can also make monetary policy more in support of investment promotion through reducing the uncertainty that is associated with changes in interest rates, which has a negative impact on investment. One way to accomplish this is to link interest rate changes to real GDP growth, or the unemployment rate for countries where the data are available on a timely and regular basis. This will reduce policy uncertainty and encourage firms to invest.

A third structural constraint in African financial systems is the shortage of long-term finance, which creates a major problem for investors who want to make long-term investments. The shortage of long-term finance in Africa is in part due to the fact that the financial system is dominated by banks which have a predominantly short-term funding base and so are hesitant to finance long-term investments. Development banks can play an important role in making long-term finance available to investors. Following their independence, most African countries created development banks to make financing available for long-term projects with high social returns but for which it was difficult to obtain private finance. Many of these banks had poor performance and had to be restructured, privatized or closed in the 1970s and 1980s. However, their privatization and closure did not address the market failures that development banks were meant to deal with in the first place. Access to finance for long-term projects and for new as well as small and medium-sized enterprises (SMEs) continues to constrain growth and development in Africa. This has rekindled interest in the role of development banks in Africa and how they can be better managed to deliver on their mandate of providing long-term finance. The lessons of development banking over the past few decades suggest that success requires following certain principles. These principles include that development banks should have a clear but flexible mandate, have operational autonomy, adhere to sound governance and management practices, and be assessed on a regular basis against agreed goals. They should also develop rather than compete with the private sector (Thorne and Du Toit, 2009).

Capital market development can also enhance access to long-term finance for entrepreneurs. It will enable African countries to transform long-term savings, for example from pension funds and insurance, into long-term investments. There are currently 23 securities exchanges in Africa most of which are relatively small, as evidenced by the low levels of market capitalization and also the number of listed and traded companies (table 7). Given the small size of African economies, capital market development will be more effective in channelling savings into long-term investments if it is done at the continental or regional level. In the light of this fact, the African Union commissioned a technical study aimed at assessing the feasibility of a pan-African stock exchange and offering recommendations on how best to enhance regional cooperation on capital market issues. There are also ongoing efforts at the regional level. For example, in West Africa, the Bourse Régionale des Valeurs Mobilières, the Ghana Stock Exchange, the Nigerian Stock Exchange, the Sierra Leone Stock Exchange, and their regulators, have an initiative aimed at harmonizing rules and creating a common platform so as to enlarge the market for issuers, brokers, and buyers of securities. The four stock exchanges and their regulators inaugurated the West African Capital Market Integration Council on 18 January 2013 and signed its charter (African Securities Exchange Association, 2013). Although regional capital market development has the potential to address the problems of illiquidity, small size and fragmentation of stock exchanges in Africa, it should be acknowledged that there are significant challenges associated with integrating capital markets in Africa. The inconvertibility of most African currencies, the lack of harmonization of legislation such as bankruptcy and accounting laws, the tendency of African countries to view stock exchanges as national assets, and the fear by smaller countries of being overshadowed by bigger exchanges are some of the challenges that have to be overcome if significant progress is to be made in effectively integrating stock markets in Africa.

Improve the policy and investment environment

The policy and investment environment also affects the incentives that firms have to invest. In particular, it affects transaction costs as well as the competitiveness of domestic firms. Addressing this issue requires policy measures in three areas. First is the strengthening of infrastructure development. Closing Africa's infrastructure deficit can stimulate a significant increase in private investment in the continent. However, such investments will not materialize unless policies are put in place to address specific bottlenecks to expanding infrastructure in Africa. Examples of these bottlenecks include the high costs of providing infrastructure in remote or

Table 7. Stock market indicators in some countries in Africa (as at March 2013)

Exchange	Market capitalization (US\$)	Number of traded companies
Bourse Régionale des Valeurs Mobilières	9 773 703 971	60
Botswana Stock Exchange	49 947 142 300	28
Casablanca Stock Exchange	49 901 617 131	74
Cape Verde Stock Exchange	347 484 369	20
Dar es Salaam Stock Exchange	8 497 749 163	11
Douala Stock Exchange	227 794 544	12
Johannesburg Stock Exchange	936 842 365 835	372
Lusaka Stock Exchange	9 566 000 000	19
Malawi Stock Exchange	652 994 374	12
Mozambique Stock Exchange	1 005 724 240	1
Nairobi Securities Exchange	18 602 307 704	57
Namibian Stock Exchange	145 695 945 447	21
Nigerian Stock Exchange	105 703 672 295	158
Rwanda Stock Exchange	1 941 963 068	2
Stock Exchange of Mauritius	7 676 599 596	89
Tunis Stock Exchange	8 985 598 100	59
Uganda Securities Exchange	7 510 034 574	8
Zimbabwe Stock Exchange	4 726 336 602	67

Source: African Securities Exchange Association (2013).

less-densely populated areas, the high costs of infrastructure services, resource constraints, and the slow pace of regional integration, which inhibit benefiting from the economies of scale in the provision of infrastructure. The development of regional infrastructure is needed to permit countries to tackle their infrastructure deficits collectively while benefiting from scale economies, generating public goods externalities and boosting intra-African trade that in turn can stimulate intra-African investment. In this context, the implementation of the African Union Programme for Infrastructure Development in Africa (PIDA) is critically relevant. The PIDA Priority Action Plan consists of 51 priority infrastructure backbone projects and

programmes on energy, water, transport, and information and communications technologies. Financing the PIDA is an important challenge to be met and the African Union has identified a series of innovative financing mechanisms to mobilize the needed resources; these include infrastructure bonds (with the Southern African Development Community, the Common Market for Eastern and Southern Africa, and the East African Community considering issuing regional infrastructure bonds), provision of loan guarantees to private investors by development banks, the harnessing of new financing partnerships with countries like Brazil, China, the Russian Federation and India to finance projects, and the imposition of community levies by regional economic communities.

In the face of limited resources, African Governments will have to continue to resort to PPPs to secure more funding for their infrastructure investments. They will, however, have to address issues that limit the emergence and effectiveness of PPPs in several African countries. These include inadequacies in the legal and regulatory frameworks of African countries, lack of technical skills to manage PPP programmes and projects, unfavourable investor perceptions of country risks, small market size, limited infrastructure and others. African States could aim to multiply these PPPs as a way to finance their investment needs while putting in place measures to address the constraints limiting the effectiveness of their public–private approach. New PPP models, such as those that involve the use of diaspora or remittance-based funds, which integrate the realities and potential of the continent should also be tried. There is also the need for African Governments to expand the range of financing instruments for public investment. A potentially fruitful avenue is the development of domestic-currency infrastructure bonds, which have been successfully tapped in a few countries, for example Kenya. The use of domestic-currency bonds to finance public investment has several advantages beyond boosting domestic investment. This form of financing helps reduce African countries' dependency on foreign-currency-denominated public debt. By developing long-term debt instruments, bond financing of public infrastructure can also stimulate the deepening of domestic bond markets and the financial system in general. To the extent that bonds are well structured, they can attract a large pool of investors, thus expanding the investor base. African Governments should also try to generate more resources for infrastructure investments through securitization of remittances and use of excess foreign exchange reserves. Some studies suggest that over the period 2000–2011 African countries on average held between \$165.5 billion and \$193.6 billion in excess reserves per year, which is more than the estimated infrastructure financing

gap for the continent (Mbeng Mezui and Duru, 2013). Furthermore, it is estimated that the continent can raise as much as \$10 billion annually through securitization of remittances (NEPAD and ECA, 2013).

The second area where there is the need for policy measures to make the policy and institutional environment more conducive to investment is in addressing issues of governance. The quality of governance has a direct bearing on private investment and the nature and productivity of that investment. Governance is used here in a broad sense and covers issues such as the quality of the policies pursued by Governments (for example, the degree of maintenance of macroeconomic stability), efficiency levels of institutions and quality of bureaucracy, respect by the State for rule of law and codified rights, rules to promote accountability, transparency and lessening of corruption, maintenance of political stability and respect for the political rights of the populace. Poor governance increases the costs of doing business for investors and entrepreneurs, it introduces elements of risk and uncertainty in the investors' decision-making calculus that affects their expected rate of return on investment, and it can create distortions in investment decisions that leads to suboptimal outcomes being realized for the economy. To stimulate investment in Africa, there is the need for Governments to improve the state of governance in the continent. In particular, African Governments should strive to do the following: maintain political stability; improve bureaucratic efficiency in State institutions and public sector bodies to reduce the costs of doing business for investors; reduce the risks associated with policy reversals by having more continuity and transparency in macro policies; set up mechanisms between the State and private investors to encourage regular dialogue and consultations between the State and the private sector; strengthen the judiciary apparatus and its independence in order to encourage respect for rule of law and promote peace and security.

The third element required to improve the policy and investment environment in Africa is the strengthening of human capital development. Firms are unlikely to invest if they do not have ready access to a reliable source of workers with relevant skills. Recent surveys indicate that the shortage of skilled workers is a major constraint facing firms in Africa. There is the need for Governments to review the educational curriculum to ensure that secondary and tertiary institutions are better prepared to respond to the needs of enterprises. There is also the need to strengthen support for technical and vocational training programmes and to incentivize the private sector to provide more on-the-job training as well as to support applied research and development activities in universities and research institutes.

Reduce inequality in income and asset distribution

African Governments should also pay more attention to income and asset distribution issues if they want to make more progress in boosting investment and achieving sustained economic growth. Reducing inequality in income and asset distribution will broaden the base of ownership in the economy and decrease the likelihood of distributive conflicts which, as discussed in previous chapters, increases risks and uncertainty, thereby discouraging investment. UNCTAD (2012c) identified some policy measures that Governments could adopt to reduce inequality. These include the introduction of legal minimum wages, greater taxation of wealth and inheritance, well-targeted social transfers and provision of social services. Given the heterogeneity of African countries, the preferred policy instrument for reducing income inequality will vary from country to country. For example, in some countries it may make sense to use a progressive tax, with the revenue spent on social services that will benefit the poor. In other countries there may be the need to consider asset-based distribution and policies to ensure that workers are paid decent wages. In countries where asset-based distribution is deemed necessary, it should be done in a way that does not lead to a disruption of investment and economic activity. In this regard, collective bargaining between Governments and relevant parties will be needed to ensure that such distribution achieves the stated objectives without leaving undesired consequences.

Strengthen regional integration and promote regional production networks

Regional integration is critical to addressing several of the key development challenges facing Africa. For example, some investments in infrastructure have to be cross-border to be cost-effective and so strengthening regional integration will play a key role in boosting investment on the continent. African leaders are aware of this crucial role of regional integration and have renewed their political commitment to the integration process, the most far reaching being the January 2012 decision to boost intra-African trade and fast-track the establishment of a continental free-trade area. While these efforts are commendable, African Governments should do more to lift the binding constraints to regional integration in Africa, some examples of which are the lack of implementation of agreements, low development of productive capacity, inequitable sharing of the benefits of integration, overlapping membership of regional economic communities, political instability, and lack of accessible and efficient cross-border infrastructure. Over the past decade, African Governments have strengthened efforts to develop regional infrastructure on the continent and have adopted the PIDA as the medium- and long-term framework for infrastructure

development. If they can mobilize adequate financial resources and implement the plan it will go a long way towards boosting investment and growth on the continent.

Strengthening regional integration can also have an impact on investment in African countries if it facilitates the development of regional production networks and value chains. Regional value chains have the potential to enhance the competitiveness of African enterprises and catalyse investment. They can also provide an opportunity to countries in the region to link gainfully into global value chains and increase their bargaining power with lead firms in those global value chains. Regional value chains should therefore be integrated into national strategies to promote investment. Facilitating regional trade through, for example, provision of adequate infrastructure and finance will go a long way towards promoting the development of regional value chains. In addition, the public sector should provide support for technical innovations and research and development to link producers into the value chains and help them upgrade into higher segments of the value chains. Skill development should also be an integral part of the package for developing such value chains. Furthermore, provision of timely market information, for example, on prices and quality standards, can help small producers in food chains to make strategic decisions concerning investment, production and sales.

B. ENSURING THAT INVESTMENT GOES TO STRATEGIC OR PRIORITY SECTORS

Another important aspect of catalysing investment for transformative growth in Africa is ensuring that investment goes to productive and strategic sectors deemed crucial for sustained and transformative growth. Obviously, the decision on which sectors should be considered strategic or priority should be made at the national level and is usually reflected in national development plans. Nevertheless, experience has shown that investment is likely to have more developmental impact in Africa if it goes to infrastructure and production sectors, such as agriculture and manufacturing, which are crucial for job creation and promoting inclusive and sustained growth. In this context, a key question is: how can African Governments influence or redirect investment to these production sectors? The development experiences of both developed and emerging economies have shown that Governments can influence the allocation of investment to desired sectors or activities through industrial policy. Therefore, African Governments should adopt such a mechanism and associated instruments to redirect investment to identified priority sectors. For example, to

ensure that banks finance activities in priority sectors, central banks can adopt a refinancing (discount) policy that favours lending for investment by setting a differentiated discount rate that is lower for bank advances dedicated to financing investment in strategic sectors or activities. Another strategy is to use an asset reserve requirement formula whereby banks can choose to satisfy their reserve requirement by either lending to finance investment in priority sectors or hold sterile cash as reserves at the central bank. So, for example, the central bank could decide to require banks to hold the equivalent of 15 per cent of total deposits in loans to investors in priority sectors. A commercial bank would have two options: it could cooperate and finance investment in the priority sectors, or it could decide to hold unremunerated cash as reserves at the central bank. Through such a strategy, the central bank would implicitly increase the relative cost of idle cash (excess reserves) held by commercial banks, which would stimulate lending for investment.

Commercial banks in African financial systems tend to focus their lending on high turnover activities, such as commerce, to the detriment of productive activities, notably agriculture and industry. In Ghana, for example, 26.5 per cent of bank credit for 2012 went to the commercial and financial sectors and 26.3 per cent went to the service sector. On the other hand, the manufacturing sector accounted for 11 per cent, while agriculture, forestry and fishing accounted for about 5 per cent (table 8). Similar patterns of distribution of credit has been observed in Lesotho where, in the quarter ending June 2012, 20.3 per cent of credit extension to enterprises went to non-bank financial institutions and real estate, 19.3 per cent to wholesale, retail

Table 8. Distribution of credit by sector in Ghana in 2012

Sector	Percentage
Agriculture, forestry and fishing	4.8
Electricity, water and gas	7.9
Construction	8.4
Mining and quarrying	2.1
Manufacturing	11.0
Services	26.3
Commerce and finance	26.5
Transport, storage and communication	4.8
Miscellaneous	8.0

Source: Ecobank: Middle Africa Insight Series – Banking, 12 September 2013.

and hotels, 16.4 per cent to transport, storage and communications, and 13.8 per cent to manufacturing (Central Bank of Lesotho, 2012).

It is interesting to note that the skewed distribution of credit towards the non-production sectors has also been observed in relatively big economies in Africa. For example, in South Africa available data for the sectoral distribution of credit in June 2012 indicate that 35.9 per cent of bank credit went to the private household sector, 24.7 per cent to financial intermediation and insurance, 4.4 per cent to manufacturing and 1.7 per cent to agriculture, hunting, forestry and fishing (South African Reserve Bank, 2012). The sectoral distribution of loans in Kenya for 2012 also shows that the household and trade sectors account for the bulk of lending. Interestingly, the manufacturing sector received only 13.5 per cent of loans even though its share of non-performing loans is relatively small (table 9). Inadequate financing to the production sectors contributes to low overall investment performance. Thus strategies to stimulate investment must include measures to incentivize lending to agriculture and industry. The asset reserve requirement system discussed earlier may help to induce bank lending to these sectors, especially when they are complemented with risk mitigation measures.

Table 9. Distribution of loans and non-performing loans in Kenya, by sector, 2012 (Percentage)

Sector	Gross loans	Non-performing loans
Agriculture	4.9	7.2
Manufacturing	13.5	6.5
Building and construction	5.2	4.1
Mining and quarrying	1.1	0.5
Energy and water	3.9	1.6
Trade	19.8	22.4
Tourism, restaurants and hotels	2.4	3.0
Transport and communication	7.4	7.7
Real estate	13.3	11.6
Financial services	3.9	2.3
Personal/household	24.6	33.2

Source: *The Financial Sector Stability Report 2012*, December 2012, issue 4, published by major financial sector regulators in Kenya, available at http://www.cma.or.ke/index.php?option=com_docman&task=doc_download&gid=254&Itemid=102 (accessed 20 March 2014).

Another area where industrial policy can play a crucial role in encouraging investment to priority sectors is in enhancing credit to SMEs. While the SME sector accounts for a large share of production and employment, it receives a relatively small share of bank credit. However, SMEs have the potential to play a major role in private sector development in general and private investment in particular. Formal financial intermediaries find the SME sector too risky and lending to small entities too costly, whereas microfinance institutions that cater for the informal sector do not have sufficient capital to meet the borrowing needs of the SMEs. There are also demand-side constraints that hinder access to credit for SMEs. These include lack of collateral, limited managerial capacity of owners, high volatility of income flows, and high and interrelated covariant risk in key activities such as agriculture. The traditional formal banking sector is ill equipped to supply credit under those circumstances. This implies the need for specialized financial institutions that embrace promotion of investment financing for SMEs as their mandate. It also requires innovation in the way in which financial institutions originate, disburse and recover loans to SMEs. In particular, the process of assessment of bankability for SMEs must be more flexible with regard to guarantee and collateral requirements and focus more on prospects for income generation. Moreover, repayment contracts must be tailored to the income flow of the borrowers. Thus, for enterprises operating in activities with high but regular seasonality of income flows, loan repayment contracts can be designed in such a way that debt service is synchronized with income flows. Such an approach has been implemented by microfinance institutions in some developing countries, for example the Plurinational State of Bolivia, with satisfactory results. African Governments should explore this possibility for expanding access to credit for SMEs and informal sector operators in general. African Governments should also look into the possibility of encouraging banks to use the flow of remittances as collateral for SMEs that seek finance for investment.

The establishment of credit guarantee systems can also increase flows of funds into targeted sectors and groups. Such systems permit sharing risks associated with lending and can improve loan quality in cases where the guarantee manager is also charged with the responsibility of assessing and monitoring loans. They are increasingly being used in Africa at the regional and national levels (box 5). The Alliance for Green Revolution in Africa, established in 2006 to lessen the risks of lending to agriculture, is the most visible regional guarantee fund on the continent. There are also national-level funds in several African countries including Tunisia, South Africa, the United Republic of Tanzania, Uganda and Nigeria. While

guarantee funds can play a crucial role in enhancing access to credit, it should be noted that they have had mixed performance in developing countries due in part to lack of transparency and accountability, political interference, and the fact that they tend to depend on government support to survive. In this context, if African Governments want to use guarantee funds to facilitate credit to priority sectors, they have to design and manage them effectively to ensure that they are financially viable. This requires that they have independent professional management, are free from political interference, and have transparent accounting, supervision and evaluation.

In the non-financial area, there are also policy measures that Governments can take to influence the allocation of investment into priority sectors of an economy. For example, the Government can provide information to entrepreneurs on investment opportunities available in priority sectors. This could be information gathered through public sector research or through consultations and interactions with the private sector. The provision of such market information can play an important role in encouraging new investors to move into the desired activities and sectors. Direct government involvement may also be necessary in some activities, such as infrastructure, to encourage the private sector to invest in these areas. This involvement could be in the form of joint ventures between the Government and the private sector.

Box 5. The African Guarantee Fund for small and medium-sized enterprises

The AfDB recently strengthened efforts to enhance access to finance for SMEs. In June 2012, the Bank officially launched the African Guarantee Fund which is a joint venture between the AfDB and the Danish and Spanish Governments. The Fund is expected to permit banks to address the financing needs of SMEs, increase their exposure to SMEs, and increase their capacity to assess SMEs. The Fund began operations in 2011 with a guarantee capital of \$50 million provided by the AfDB and the Danish and Spanish Governments. However, it is expected that the share capital will increase to \$500 million over the next few years with additional capital from private investors, development finance institutions and other bilateral donors. The Fund provides partial financial guarantees to lending institutions and capacity-building support to lending institutions and SMEs. The company was incorporated under the business law of Mauritius as a company limited by shares.

Source: AfDB.

C. IMPROVING THE PRODUCTIVITY OR QUALITY OF INVESTMENT

The third component of catalysing investment for transformative growth in Africa is to improve the productivity or quality of investment. The evidence presented in earlier chapters suggests that there has indeed been an improvement in the productivity of aggregate investment in Africa over the past two decades but that there are also a large number of countries where the productivity of capital has either not changed or declined significantly over the same period. This underscores the need for African policymakers to strengthen efforts to improve and sustain the quality of investment. Enhancing the productivity of private investment in Africa requires easing binding constraints affecting competitiveness of enterprises. These include, among others, skills shortages, poor infrastructure, low access to finance, and high costs of factor inputs. It also requires firms targeting investments in sectors with higher value addition. Some of these issues cannot be effectively addressed without public investments in both hard and soft infrastructure. Increasing the quantity of public investment is basically a resource mobilization issue and this and other related finance issues have been addressed in previous sections. Therefore, the focus of this section is on how to improve the quality of public investments.

There are two approaches that have been used to assess the efficiency and quality of public investments. The first is based on physical (outcome-based) indicators, such as electricity generation losses as a per cent of total electricity output, or the percentage of paved roads in good condition. The second approach focuses on the quality and efficiency of the investment process. For example, using the second approach, Dabla-Norris et al., (2011) found that countries in sub-Saharan Africa are relatively weak in all stages of the public investment management process (project appraisal, selection, implementation and evaluation). They also found that oil exporters have lower public investment management index than other countries in the sample. The evidence suggests that African policymakers have to make more efforts to improve the quality and efficiency of public investments. This would require reducing inefficiencies in public investment management through better project selection and delivery and also making the most of existing infrastructure assets (McKinsey, 2013). Some policy measures that could be adopted to improve productivity in each of these areas are discussed below.

Better project selection and delivery

Poor project selection and inefficiencies in project delivery due largely to weak technical expertise, limited information and poor governance are some of the factors that account for the low productivity of public investments in Africa. Projects are often poorly conceived and do not have a clear metric in the sense that they do not address clearly defined needs. In addition, project evaluation tends to be done in isolation rather than as part of a broader effort to achieve national development goals. Significant delays are also encountered in project delivery due in part to regulatory bottlenecks. In this regard, shortening the time it takes for project permit approvals and land acquisition will result in significant savings that could be used to address other development needs. There is the need for African Governments to address these weaknesses in public investment management in order to enhance the productivity of such investments and fully reap their benefits. The establishment of an independent and transparent approach for project evaluation, prioritization and decision-making is necessary to avoid project decisions being driven by political exigency. Building public sector capacity, particularly in using robust project selection and evaluation methods, and project delivery, is also important.

Getting more value out of existing infrastructure

In Africa, there tends to be more focus on new infrastructure projects than on getting more value out of existing infrastructure assets through more efficient use and better maintenance of such assets. There are significant savings to be made from improved asset utilization in Africa. For example, a recent study indicates that electric power transmission and distribution losses in Africa were about 12 per cent of output in 2010. There is also direct loss of time and productivity due to traffic congestion, which by one estimate is as high as \$8 billion per year in Cairo, \$19 billion in Lagos, \$0.89 billion in Dar es Salaam and \$0.57 billion in Nairobi (Ondiege et al., 2013). Reducing these inefficiencies, for example through better project management and implementation, should be on the priority list of African Governments in the short to medium term.

Another factor that makes it challenging to get more value out of existing infrastructure assets in Africa is poor maintenance of assets due largely to inadequate provision for infrastructure maintenance in African national budgets. This lack of adequate funding for maintenance reduces the lives and productive value of public investments, resulting in waste and inefficiency, which is unfortunate

given the limited resources that countries have at their disposal. One study suggests that if African countries had spent \$12 billion on road maintenance in the 1990s they would have saved \$45 billion in reconstruction costs (McKinsey, 2013). African Governments should pay more attention to infrastructure maintenance through earmarking increased resources for such projects in the national budget. This would, however, require mainstreaming maintenance more effectively into infrastructure planning and development.

More targeted public investment is needed

Given the limited financial resources available to African Governments, there is the need for better targeting of public investments to enhance their impact. The focus of public investment should be on lifting the most binding constraints to development. Within infrastructure, for example, the focus should be on energy and transport which have been identified as the critical factors inhibiting the development of productive capacities in the region. Other infrastructure areas such as telecommunications are important but they are not as constraining as energy and transport. Over the past decade there has been an increase in private sector participation in infrastructure in Africa. But most of the new investments is in telecommunications, with very little going to energy and transport, which are more binding constraints to the development of productive activities in the continent. Refocusing public investment in areas, such as energy and transport, where it has been difficult to get adequate private sector participation will go a long way towards enhancing the impact of such investments. Better targeting of public investment may require Governments to make a distinction between productivity-enhancing and utility-enhancing public investment, and to allocate more public expenditure towards the first category. Productivity-enhancing investments such as infrastructure are important drivers of transformative growth and should be accorded priority in allocation of public expenditure. Utility-enhancing investments such as expenditures on national defence and parks for example are useful but do not make any direct contribution to economic transformation and so should have less priority in budget allocations.



CHAPTER 4
**POLICIES FOR CATALYSING
INVESTMENT IN AFRICA:
INTERNATIONAL ASPECTS**

Although the primary responsibility for catalysing investment in Africa rests principally with national Governments, the international community also has an important role to play because the global environment has a bearing on the ability of African countries to effectively boost and use investment for transformative growth in Africa. The global environment also affects the kinds of policy instruments and space that African Governments have with which to promote investment. In this context, concerted actions are needed at the national, regional and international levels to stimulate investment in Africa. Against this backdrop, this chapter focuses on selected international economic issues that affect investment in Africa. These are strengthening linkages between local and foreign enterprises, stemming capital flight to release more resources for investment, using aid to catalyse investment, and boosting investment through fostering international trade.

A. STRENGTHENING LINKAGES BETWEEN LOCAL AND FOREIGN ENTERPRISES

FDI is an important channel available to open economies to complement domestic savings and contribute to domestic capital accumulation. In 2012 Africa received \$50 billion in FDI inflows, representing about 3.7 per cent of global inflows (UNCTAD, 2013a). While the amount of inflows received by the continent in 2012 represents an increase relative to the \$44 billion received in 2010, it is still less than the 2008 figure of \$59 billion which was about 3.2 per cent of global inflows. Despite the recent increase in FDI flows to Africa, the continent continues to attract relatively small FDI compared to other continents. Although in the last few years the continent has attracted significant FDI flows into the manufacturing and services sectors, the extractive industries account for the bulk of FDI flows to Africa over the past decade. Increased industrial growth in developing countries like China and India has added to the international demand for these resources and increased investments in exploration and exploitation of natural resources in Africa. While the resource rents associated with these investments contribute to development finance in Africa, the general developmental impact of FDI flows on the continent has been limited due in part to low backward and forward linkages between local and foreign enterprises. Amendolagine et al. (2013) have examined the factors that affect linkages between foreign and local firms using firm-level data for 19 countries in sub-Saharan Africa. The main factors considered were the characteristics of foreign firms and the macroeconomic environment of the host country. They found,

among other aspects, that (a) foreign firms tend to increase linkages over time as they gain better knowledge of local opportunities; (b) foreign firms with local partners and those with a final-market orientation interact more with local firms; (c) foreign firms have more linkages with local firms when the local management possesses more autonomy from company headquarters; (d) diaspora investors tend to have more linkages than foreign investors; (e) a reliable legal system and well-functioning institutional setting facilitate linkages. In addition to the factors mentioned above, the lack of a vibrant domestic private sector, lack of availability of adequate infrastructure and skilled labour, low absorptive capacity, and policy incoherence also contribute to weak linkages between local and foreign enterprises in most African countries. Vibrant and dynamic local firms can absorb technology and knowledge spillovers faster and contribute to investment, productivity and employment, strengthening domestic demand in the process. This suggests that to maximize the benefits of FDI, it is important to have a vibrant and dynamic private sector. In this regard, the promotion of FDI should not be done in isolation but rather as part of an overall strategy to boost private sector development. Some of the policy measures that could be adopted by African Governments to foster linkages between local and foreign enterprises are described below.

Develop and improve workforce skills and raise absorptive capacity of local firms

The level of human capital development and the characteristics of local firms affect the creation of linkages between local and foreign firms. It is very challenging for foreign firms to have strong linkages with local firms when the latter do not have adequate skilled labour to absorb the technology provided by foreign firms. Furthermore, in economies where the structure of local firms is such that firm size is very small it is difficult to develop linkages. These facts suggest that developing human capital and facilitating growth of local firms will play an important role in fostering linkages between local and foreign firms. Enhancing access of local firms to affordable finance and provision of good quality infrastructure are some ways to promote the growth of local firms and increase their capacity to effectively benefit from partnerships with foreign firms.

Technology transfer requirements have been used by developed countries and emerging economies to create linkages and enhance the developmental impact of FDI. While local content requirements are prohibited under the Agreement on Trade-Related Investment Measures, export and technology transfer requirements have not been prohibited and so can in principle be used by African countries to strengthen linkages between local and foreign enterprises. However, it should be

noted that this policy instrument can only be used by African countries that have not signed bilateral agreements with developed countries (or emerging economies) restricting the use of performance requirements. The use of technology transfer requirements permits countries to build the capabilities of local enterprises and make them more competitive. But implementing performance requirement policies is not an easy task, particularly where developing domestic capacities is not of interest to some foreign firms. In this context, for countries that choose to use performance requirements, there is the need to have a good mechanism for monitoring compliance of these requirements. In the case of manufacturing, some minimum threshold of industrial base will be required in host countries for FDI to successfully develop linkages with the domestic sector. The State can contribute to broadening the industrial base and to the development of local private enterprises through incentives and schemes to build their capital base as well as their entrepreneurial skills.

Enhance use of local inputs and promote value addition

FDI can also contribute to building domestic capabilities and capacities and catalyse more investment by local investors. This can be facilitated through, for example, using targeted economic incentives to encourage foreign firms to hire labour locally and also make more use of other local inputs. African Governments should also strengthen efforts to incentivize export-oriented foreign firms to add more value to their exports domestically. Higher domestic value addition in exports by foreign firms can have important knowledge spillovers on local firms and spur investment. Some developing countries have used export restrictions such as export taxes and, in some cases, export bans on raw materials to preserve natural resources and increase processing and value addition. Some of the African countries that have used this instrument include Cameroon, Chad, the Congo, Ethiopia, Ghana, Guinea, Mauritania, Nigeria, Sierra Leone and Zambia. Mixed evidence exists on the success of export restrictions in increasing domestic value addition (box 6). Nevertheless, the experience from countries that have used this instrument suggests that factors which determine the success of export restrictions in increasing domestic value addition include the availability of adequate and reliable skilled labour, access to affordable finance and good infrastructure, and the domestic capacity to absorb and adapt technologies.

Box 6. Value addition in the leather industry in Ethiopia

Ethiopia produces large quantities of raw and semi-processed hides, and, until recently, there was very little transformation of the hides and skins into high-quality leather. This meant that the country could not benefit from the significant gains associated with participation in the higher value segment of the value chain. In 2002, the Government made a decision to promote upgrading in the industry. It imposed an export tax of 150 per cent on exports of hides. It complemented this with support for exporters through the development of industrial zones and assistance to local firms to enter into partnerships with foreign investors. Training to facilitate upgrading was also provided to employees of local firms through the Leather Products Technology Institute established in July 1999. These measures influenced foreign firms to start supporting the local tanning and manufacturing firms to upgrade their activities. As a result, there has been a significant shift in the composition of exports in the industry from raw and semi-processed hides to finished products.

Source: ECA and African Union (2013).

Encourage joint ventures between local and foreign enterprises

Promoting joint ventures is another way that African countries can strengthen linkages between local and foreign enterprises. The developmental impact of FDI tends to be higher when investment takes the form of joint ventures as compared to wholly owned foreign firms. They allow local enterprises to benefit from the skills and innovation capabilities of foreign enterprises. African Governments should consider innovative ways to incentivize foreign enterprises to enter into joint ventures with local enterprises. For example, in resource-rich countries, the Government can link access to natural resources to the establishment of joint ventures and the development of infrastructure. Providing targeted economic incentives for the processing of raw materials for exports through joint ventures is also a strategic policy intervention that can promote inter-industry and intra-industry technology spillovers and strengthen the domestic private sector in Africa. Other measures that could contribute to the promotion of joint ventures in Africa include improving the state of infrastructure, human capital development, maintaining peace and security, and financial market development. There is the need for African Governments to strengthen efforts in each of these areas to encourage foreign firms to enter into joint ventures and create linkages between foreign and local enterprises.

Make foreign direct investment policy consistent with promotion of domestic entrepreneurship

Policy incoherence associated with the promotion of FDI has also contributed to the low linkages between local and foreign firms in Africa. In an effort to attract more FDI, African countries tend to offer very generous incentives to foreign investors that often put local investors at a disadvantage. These incentives include tax holidays and tax rebates to foreign firms, income tax exemptions, investment allowance and exemptions from customs duty, and exemption from duty and value-added tax. In general these incentives have proved to be counter productive and have not succeeded in increasing FDI to the strategic and priority sectors of the economy. In fact, these incentives are generally detrimental to the growth of local enterprises and entrepreneurship. Like many African countries, Mozambique has used generous tax incentives to attract FDI and continues to use complex sets of fiscal incentives to promote foreign investments, especially in extractive industries. However, there is an increasing recognition that these incentives should be assessed in terms of costs, benefits, efficiency and fairness. In particular, incentives provided tend to target big investors, thereby putting local firms at a disadvantage since they tend to be small (UNCTAD, 2012d). Similarly, in Zambia, the fiscal regime favours large investors with investments of \$500,000 and above. In addition, the corporate income tax rate on mining (30 per cent) is less than that on manufacturing (35 per cent) which is not consistent with the policy of promoting diversification and transformation towards manufacturing (UNCTAD, 2014). In Lesotho, an attempt by the Government to promote manufacturing investment by offering incentives to manufacturing businesses created a bias against local investors who were mostly in services (UNCTAD, 2013b). In order to have an FDI policy that is in line with the objective of promoting domestic entrepreneurship, there is the need for incentives to be provided in a manner that does not discriminate against local investors. Furthermore, incentives should be used mainly for promoting new investments in activities where a country cannot attract investors without such incentives. For example, in most cases incentives are not necessary to attract FDI in the extractive industry because such investments will take place anyway given the high demand for resources and investor interest in the sector.

B. STEMMING CAPITAL FLIGHT TO BOOST INVESTMENT

Although lack of finance is one of the major constraints to boosting investment in Africa, each year the continent loses significant amounts of financial resources in the form of capital flight. It is estimated that capital flight from Africa, in terms of unrecorded outflows of private capital, stood at \$50 billion a year in the period 2000–2008, exceeding ODA to the continent, which stood at \$46 billion in 2012. According to Boyce and Ndikumana (2012), 33 sub-Saharan African countries have lost \$814 billion between 1970–2010, which is higher than the amount of ODA and FDI they received in this period. Oil-rich countries are at the top of this list, accounting for around 43 per cent of the total capital flight in the period 2000–2010. African countries could achieve much higher investment rates compared to the current level if this capital was reinvested in their countries. For example, it is estimated that Angola, Burundi, Mozambique, Seychelles and Sierra Leone could double their capital formation by curbing capital flight. By eroding the tax base and depleting domestic resource mobilization by the Governments, capital flight retards government expenditures and growth, undermining poverty-reduction efforts. Some of the major causes of capital flight as identified in the literature are perceived high risks associated with domestic assets, political uncertainties, poor governance, macroeconomic mismanagement and instability, misaligned exchange rates, weak institutional environment, and corruption and lack of transparency.

Efforts are required at the international, regional and national levels to curb capital flight. For example, greater international cooperation is required to prevent tax evasion and the illicit transfer of capital. Many developed countries have weak disclosure standards which encourage illicit capital flight, especially from resource-rich African countries. Furthermore, tax havens encourage transfer pricing and tax evasion by multinational firms. Some efforts have been made at the international level to address the issue of tax evasion. For example, the G20 countries have taken initiatives to jointly curb tax evasion by multinational companies. These initiatives include plans such as “base erosion and profit shifting”, which target the attempts of multinational companies to shift tax base to low tax jurisdictions to evade taxes in the host countries. G20 countries have proposed that there should be strict rules for declaring permanent base by multinational companies. At the June 2013 G8 summit, leaders of G8 countries also committed to fight tax evasion at the national and international levels. In particular, they committed

to ensure that tax authorities share information to fight tax evasion; change rules that permit multinationals to shift profits across borders to avoid taxes; ensure that multinational companies report the amount of tax they pay and where to tax authorities; help developing countries to collect taxes owed to them; and ensure that extractive companies report payments made to all Governments and that the latter publish such information.

At the regional level, African countries are also taking steps to curb illicit outflow of capital. For example, a 10-member High Level Panel on Illicit Financial Flows was set up in February 2012 by the ECA and the African Union. The High Level Panel is chaired by Mr. Thabo Mbeki, former President of South Africa, and its mandate is to promote better understanding of the nature of illicit financial flows, assess its developmental impact, and facilitate the adoption of measures to address the issues at the national, regional and global levels. Other initiatives at the regional level include the African Peer Review Mechanism aimed at promoting economic and political governance, which is crucial for combating capital flight.

There is also the need for policy measures at the national level. For example, African Governments should reduce policy incoherence associated with promotion of FDI particularly in the extractive industries. Governments provide generous incentives to foreign companies operating in the extractive sector despite the fact that available evidence indicates that laundered commercial money through multinational companies is the largest component of illicit financial flows from Africa, and that about 56 per cent of illicit financial flows from the continent came from the extractive industries (NEPAD and ECA, 2013). African Governments have to rethink their policy on FDI to ensure that they do not provide incentives to companies that contribute to illicit financial flows on the continent. At the national level, there is also the need to improve tax and customs administration and also address the issue of corruption. Better technology is required in many African countries to improve customs administration and tax collection. Tax authorities lack capacity to monitor and collect taxes leading to inefficiencies and leakages. Curbing tax collection loopholes with better technology can help to curb capital flight. In September 2013, the United Republic of Tanzania adopted an electronic revenue collection system which increased compliance level among tax payers by 27 per cent, helping it stem tax evasion. Improving custom efficiency can raise the transaction costs of trade mispricing and therefore be an effective intervention to curb capital flight. However, in some cases trade mispricing occurs not because of custom inefficiencies but

because of corruption. In this regard, there is the need to control corruption at all levels in order to make more progress in curbing capital flight.

Initiatives like the Extractive Industries Transparency Initiative (EITI) can be helpful to African countries for controlling corruption and bringing more transparency in the system, especially with respect to the extractive industries sector. The initiative is based on the approach of declaring publicly the payments made by companies and revenue earned by the Governments in extractive industries. In May 2013, a new reporting standard was introduced by the EITI which makes the reporting system much more rigorous as this has to be now done at the disaggregated project level. The initiative helps in providing valuable information to the citizens and promotes greater transparency with a view to increase accountability of the Governments. As of September 2013, there were 29 EITI-compliant countries, of which 16 are in Africa. Four African countries (Chad, Guinea, Sao Tom and Principe, and Senegal) are candidate countries (implementing EITI, but not yet meeting all requirements) and three countries (the Central African Republic, Madagascar and Sierra Leone) have their compliant/candidate status temporarily suspended. There is the need for more African countries to join these initiatives to enhance transparency in the use and management of natural-resource wealth.

C. BOOSTING INVESTMENT THROUGH AID

Africa is a major recipient of ODA. Over the past decade there was a significant increase in net ODA flows to Africa from \$20.4 billion in 2002 to a peak of \$50.7 billion in 2011 and \$46.1 billion in 2012. Nevertheless, Africa's share of net ODA rose marginally from 35.5 per cent in 2002 to 38.2 per cent in 2011 and stood at 36.7 per cent in 2012. Aid can have both favourable and unfavourable impacts on investments. It can have a positive impact on investment through (a) enhancing availability of finance; (b) improving the business environment for investments (especially when aid supports projects such as infrastructure, that contributes to lowering the costs of investment); (c) raising labour productivity through increased investments in health and education; (d) providing technical assistance and training; (e) providing payments for imports of capital goods and direct technology transfers. However, aid can also adversely impact investments through appreciating the exchange rate, reducing firm competitiveness, encouraging bad governance and in some cases political instability. The uncertainty of aid can also have a detrimental impact on private investments.

The empirical evidence on the impact of aid on investment in Africa is mixed. Asongu (2012) using data for 52 African countries for the period 1996–2010, finds that development assistance has fuelled corruption in the African continent, while Addison et al. (2005) find that aid has increased public consumption without increasing investments. In contrast, Juselius et al. (2011) find a positive impact of ODA on investment in 33 of the 36 African countries considered. There are also studies presenting evidence that aid can boost investment if certain conditions such as the right policy environment and institutions exist in the country (Radelet, 2008). While there is mixed evidence on the impact of aid, there is no doubt that African countries will continue to depend on aid in the short to medium term. Therefore, the appropriate focus of African Governments and their development partners should be on how to maximize its benefits, and the key to doing this is to use it more in support of building productive capacities and promoting economic transformation in Africa. Specific policies on how to do this in the context of promoting investment are discussed below.

Use aid to stimulate investment

Traditionally aid has been used to fill the savings gap in African countries and this approach to aid delivery can have a negative impact on domestic resource mobilization and investment, because it often creates a disincentive for recipient countries to strengthen efforts to mobilize domestic resources. One way to reduce these negative consequences of aid is to use it to catalyse investment, and this can be achieved by gearing ODA towards enhancing capacity for domestic resource mobilization and also using it as a guarantee mechanism to reduce lending risks faced by banks and financial institutions. It is well known that high risks and limited access to finance are major constraints to investment in Africa. ODA can play a crucial role in lowering these risks and costs associated with investments, as well as in building human capacities required for production. The risks associated with investments can be lowered by using ODA to leverage private finance for bankable projects. It has been found that in many cases concessional loans or grants for a project can help in raising finance from other sources. According to the 2009 annual report of the European Union–Africa Infrastructure Trust Fund, each euro grant can raise 13.5 euros of investments, of which 9.9 euros comes from private sources. Availability of concessional loans or donor participation in co-financing projects can send reassuring signals to markets which can help the private sector to raise further loans with lower interest rates and extended maturities.

Donors should also strengthen local financial markets and catalyse private investment by, for example, using ODA to provide partial guarantees for long-term

bonds sold by local entities. They should also provide technical assistance to banks and financial institutions on assessing long-term investment projects because in some countries lack of liquidity in the local banking system may not be the binding constraint. The limited capacity of local banks to identify viable long-term investment projects and risks attached to such investments may be a more serious constraint. In this regard, technical support will play a crucial role in enhancing access to credit and boost investment. Given the fact that the private sector in most African countries consists of a large number of micro, small and medium-sized enterprises, strengthening the supply capacities of these enterprises is important to boost private investments. ODA can also play a crucial role in this area. This can be done by using ODA to promote expansion of business services for the private sector with a special focus on SMEs. These services raise the productivity and efficiency of businesses, thereby improving their competitiveness.

Channelling more official development assistance to economic activities and the production sectors

Another way to reduce the potential disincentive effects of ODA in Africa is to direct more of it to the infrastructure and production sectors of African economies. Over the past decade there has been a significant reduction in the share of ODA to economic activities and production due in part to increased focus on the social sectors and also as a result of debt relief initiatives. For example, in 2002 economic activities and production accounted for 20.7 per cent of gross ODA disbursements to Africa, while the social sector and debt accounted for 17.2 per cent and 19.6 per cent, respectively (table 10). By 2006, however, economic activities and production accounted for only 8 per cent of gross disbursements while the social sector and debt accounted for 10 per cent and 65.7 per cent respectively. Since then the share of economic activities and production rose to about 25.6 per cent in 2011 and the share of the social sector rose to 24.5 per cent, while that of debt fell to 12.8 per cent in the same year.

There is the need for donors to continue putting more emphasis on economic activities and production, as has been done in recent years, because they contribute to the development of productive capacities and can promote structural change which is crucial for sustainable growth and development. Encouraging development partners to provide more support for the production sector, especially agriculture and agro businesses, can help in raising agriculture productivity and also crowd in investments in non-agricultural sectors. Africa also requires massive investments in its infrastructure – both hard and soft infrastructure – to improve its

Table 10. Gross official development assistance disbursements to Africa by sector (\$ millions)

Sector	2002	2006	2011
Economic activities and production	4 246	6 846	14 580
Social sectors	3 532	8 443	13 955
Governance and conflict, peace and security	1 942	3 962	5 713
Multisector and general programme aid	3 935	5 176	8 631
Debt	4 020	56 170	7 291
Humanitarian	1 135	3 902	5 731
Other	1 685	973	958
Total	20 497	85 472	56 858

Source: ECA and Organization for Economic Cooperation and Development (2013).

productivity levels, improve its cost competitiveness and diversify its production and exports. But there is limited private investment in infrastructure in Africa despite high returns and a large infrastructure investment gap. Interestingly, the bulk of private sector investments in infrastructure in Africa is in telecommunications rather than energy and transport, which are the most binding infrastructure constraints. It is estimated that returns on investments in infrastructure projects are generally around 30–40 per cent for telecommunications, more than 40 per cent for electricity generation and around 80 per cent for roads (Kingombe, 2011). The high risks associated with infrastructure projects explain in part the low private sector interest in such investments. Furthermore, factors such as political instability, weak public administration, insufficient resources, high level of corruption, lack of long-term financing and low bankability of projects inhibit private investment in infrastructure and have to be addressed. To attract more investments in infrastructure African countries need to identify “infrastructure development” as one of their main development objectives for ODA. There is also the need to develop ODA-backed PPPs to boost investments in infrastructure. PPPs can reduce investment risks for the private sector as well as provide the necessary support. The use of ODA to overcome shortages of electricity and power, which is one of the major hindrances in accelerating investments in Africa, also needs to be promoted. In this context, it is interesting to note that President Obama recently announced the Power Africa initiative that is expected to double access to power in sub-Saharan Africa. The United States has committed \$7 billion in financial support over the next five years to this effort. Box 7 provides details of this initiative.

Box 7. Using aid to stimulate private investment through the Power Africa initiative of the United States

Africa has significant potential to generate electricity through renewable energy sources. However, it is estimated that 69 per cent of the population of sub-Saharan Africa has no access to electricity. In June 2013, the President of the United States, Barack Obama, announced the establishment of the Power Africa initiative to enhance access to electrical power in sub-Saharan Africa and lift one of the binding constraints to investment, growth and development in the region. Through Power Africa, the United States will work with its partners in the public and private sectors to bridge the gap between Africa's power shortage and its economic potential. It is expected that the initiative will result in the doubling of the number of people with access to power in sub-Saharan Africa through unlocking wind, solar, hydropower, natural gas, and geothermal resources in the region. The initiative will begin with six focus countries namely: Ethiopia, Ghana, Kenya, Liberia, Nigeria, and the United Republic of Tanzania. Furthermore, it will add more than 10,000 megawatts of clean, efficient electricity generation capacity in the region. The United States has already committed \$7 billion in financial support and loan guarantees to the first phase of the initiative, which will run through 2018. It has also leveraged two dollars in private investment for every dollar committed by the United States Government.

Source: www.usaid.gov/powerafrica (accessed 21 March 2014).

D. BOOSTING INVESTMENT THROUGH FOSTERING INTERNATIONAL TRADE

There are also potential opportunities for boosting investment through fostering international trade. For example, trade can permit African countries to access a larger market, thereby enhancing competitiveness and stimulating investment. Enhanced trade can also boost income and create more demand for local goods thereby promoting investment in the economy. But the relationship between trade and investment is not unidirectional. An increase in investment, particularly in strategic sectors, can spur structural transformation and promote trade. The complexity of this relationship underscores the need for coherent trade and investment policies in order to exploit synergies between these variables and maximize their developmental impact. Some suggestions on how international trade could be used to promote investment in Africa are discussed below:

Enhance market access for Africa in global markets

The trade policies of other countries as well as multilateral trade rules have consequences for investment in Africa. Lower market access in global markets limits export opportunities in Africa and discourages investment, especially in economies

with small domestic markets. It is therefore important for African countries to make all efforts at the international level to improve market access in advanced countries as well as in other developing countries. Although many efforts have been made in this direction, after years of multilateral trade negotiations African exports of agricultural products still face significant barriers in global markets. Domestic support measures, such as agriculture export subsidies, have limited Africa's exports of agricultural goods and hindered investments in the agriculture sector, where most African countries have a current comparative advantage. Tariff peaks and tariff escalation have also hindered value addition and upgrading in Africa with dire consequences for industrial development on the continent. There is the need for African Governments to put more pressure on the international community to address these barriers that are inhibiting Africa's capacity to derive more gains from the international trading system. But enhanced market access is only a necessary but not a sufficient condition for trade to foster investment. This underscores the need to build productive capacities in Africa so that African countries can take advantage of any market access opportunities that are provided. There is also the need for better sharing of information on available market access opportunities so that African entrepreneurs can take more advantage of these opportunities.

Facilitate trade and investment through reducing trade costs

Development in multilateral trade negotiations can also contribute to boosting investments in Africa to the extent that it reduces transaction costs of trade for African countries and facilitates trade. At the ninth Ministerial Conference of the World Trade Organization (WTO), held in Bali in December 2013, some decisions were adopted which may have implications for Africa's trade and investments. These include the Agreement on Trade Facilitation, which compels WTO members to expedite action on the movement, release and clearance of goods and also improve cooperation among themselves on custom matters. Although, many African countries have already initiated programmes to modernize their custom procedures, they still have more work to do to reduce trade costs and facilitate trade. In this regard, the recent trade-facilitation agreement will create pressures on African countries to strengthen existing efforts to facilitate trade. But it will also impose implementation costs on African countries and so it is important that African countries ensure the international community provides adequate financial assistance to enable them to defray the implementation costs that will arise from the trade facilitation agreements. There is also the need to build export capacities, particularly in the smaller African economies, because the benefit of the trade

facilitation agreement is likely to be heavily tilted towards big exporting countries and may facilitate imports into African countries adversely affecting their trade balances. The Aid for Trade initiative can play an important role in this area and should be strengthened. In Bali, WTO ministers reaffirmed their commitment to the Aid for Trade initiative. They also instructed the Council for Trade in Services “to initiate a process aimed at promoting the expeditious and effective operationalization of the LDCs services waiver” (which gives preferential treatment to services and service suppliers of LDCs). One of the areas which has been largely ignored and has received very little Aid for Trade in Africa is the services sector. With the growing trade in services, the Aid for Trade initiative should pay more attention to providing training programmes and developing skills of the workforce in the services sector. Strengthening services such as those relating to research and development, banking and financial services, branding, packaging and marketing services can bring tangible gains to recipient countries and help them in upgrading and adding value to their exports, which will contribute to boosting investment.

Ensure coherence across trade initiatives and agreements

African countries are engaged in a number of trade agreements both at multilateral and bilateral levels whose outcomes will have implications for investment on the continent. In addition to their involvement in the Doha Round of trade talks, they are also involved in the Economic Partnerships Agreements with the European Union. They also have trade agreements with the United States under the African Growth and Opportunity Act (AGOA). While these initiatives have the potential to contribute to sustained growth and development in Africa, the manner in which African countries have engaged in the negotiations so far creates room for policy incoherence across the various initiatives. It is often the case that individuals involved in negotiations under one initiative are not necessarily those involved in others, and information is not regularly shared across all relevant departments and stakeholders on a timely basis. It is important that African countries have a more coherent approach to these negotiations to ensure that the outcomes are mutually supportive of economic transformation and development on the continent.

More efforts are also required on the part of the European Union and the United States to make the economic partnership agreements and AGOA contribute more to trade and investment in Africa. With regard to AGOA, there is the need for the United States to reduce the uncertainties associated with its renewal, which could have very dire consequences for investment. Although the effects of discontinuing AGOA would vary based on the country/region and sector, with some being more

negatively affected than others, keeping AGOA in place would definitely provide much better results than a return to the Generalized System of Preferences (Mevel et al., 2013). In this context, there is the need for the United States to make a decision on whether or not to grant African countries' request to extend the AGOA until 2025 to reduce uncertainty. In terms of the economic partnership agreements, there is the need to strengthen efforts to address the concerns of African countries, which have made it difficult to conclude the agreements. African countries are concerned that the agreement may limit their policy space, hinder regional integration, and have a negative impact on economic transformation (ECA and African Union, 2013). In this regard, there is the need for the European Union to strengthen the development dimensions of the economic partnership agreements to enhance the likelihood that African countries will expedite action to conclude the agreements for mutual benefits.



CHAPTER 5
**CATALYSING INVESTMENT
FOR TRANSFORMATIVE
GROWTH IN AFRICA:
MAIN FINDINGS AND
RECOMMENDATIONS**

A. INTRODUCTION

Africa entered the twenty-first century on a very good note. The economic growth performance of most African countries over the past decade has been good relative to the continent's historical growth performance and also relative to the average growth rate for the global economy. Despite Africa's recent growth performance, there are indications that countries on the continent are experiencing the wrong type of growth in the sense that joblessness is still widespread and the growth has not led to significant reductions in poverty. One of the reasons for this phenomenon of jobless growth in Africa is that the continent has not gone through the normal process of structural transformation, involving a shift from low- to high-productivity activities both within and across sectors. In the normal process of economic transformation, economies begin with a high share of agriculture in GDP and as incomes rise the share of agriculture declines and that of manufacturing rises. This process continues until the economy reaches a relatively high level of development where both the shares of agriculture and manufacturing fall and that of services rise. The structural change observed in Africa has not followed this process. Over the past three decades the continent has moved from a state in which agriculture had a very high share of output to one in which the service sector, particularly low-productivity activities within the service sector, dominates output. This transition has taken place without any significant manufacturing development, which is critical to creating employment. It is therefore not surprising that the continent experienced jobless growth over the past decade.

Another reason why Africa's recent growth has not had a profound impact on either poverty reduction or employment creation is that it has also not gone hand in hand with the development of productive capacities, which is crucial for generating decent jobs and reducing poverty. These structural issues associated with African countries' recent growth raises the question of how the countries can achieve the high, sustained and transformative growth necessary to reduce poverty? UNCTAD (2012a) identified investment as one of the main drivers of structural transformation. Furthermore, research studies suggest that for African countries to make significant progress in reducing poverty they would have to sustain growth rates of about 7 per cent and above in the medium to long term, and this would require investment rates of 25 per cent of GDP and above. Currently, investment rates on the continent are well below this threshold. They are also low relative to what is observed in rapidly growing developing countries. Boosting investment is therefore of strategic importance to achieve the broad development goals of African countries. It is

also imperative if the continent is to achieve sustained growth and be a pole of global growth in the twenty-first century. Against this background, the *EDAR 2014: Catalysing Investment for Transformative Growth in Africa* examines how to boost and use investment in support of economic transformation and sustained growth in Africa. The term “investment” as used in the report refers to total investment in the economy, which includes public and private investment. Private investment in turn consists of investment by local private investors and FDI. The focus of the report on total investment reflects the fact that all components of investment matter for growth and development and so the focus of policy should be on how to exploit the complementarities among the various components, rather than promoting one component at the expense of the other. Some of the key findings and recommendations of this report are highlighted in the following section.

B. MAIN FINDINGS

1. Africa has low investment rates relative to the average for developing countries and also relative to what is considered necessary to achieve development goals.

The low investment rates in African countries relative to the average for developing countries is of concern given that investment is a key determinant of long-run growth and is crucial for building productive capacities, creating employment and reducing poverty in Africa. On an annual average basis, the investment rate for Africa was about 18 per cent over the period 1990–1999 compared to an average of 24 per cent for developing economies as a whole. Similarly, in the period 2000–2011, the average investment rate for Africa was about 19 per cent compared to 26 per cent for developing economies generally. These average investment rates for Africa hide substantial cross-country variation. High investment rates in the range of 25 per cent and above are rarely sustained in African countries. Over the past two decades, only a small set of African countries have sustained investment rates of 25 per cent and above, namely Algeria, Botswana, Cape Verde, the Congo, Equatorial Guinea, Guinea, Lesotho, Sao Tome and Principe, and Seychelles. The majority of African countries have low investment rates. For example, over the period 2000–2011, the following countries had average investment ratios below 15 per cent: Angola, the Central African Republic, the Comoros, Cote d’Ivoire, Guinea-Bissau, Liberia, Libya, Nigeria, Sierra Leone, Swaziland, and Zimbabwe. Research studies also suggest that Africa’s investment rates are lower than optimal levels in the sense

that they are below what is needed to sustainably reduce poverty and achieve international development goals such as the MDGs. For example, based on some studies an investment rate of 25 per cent to 33 per cent is required for African countries to be able to reach the growth rate of 7 per cent estimated to be necessary to meet the MDGs, especially the goal of reducing poverty by half by 2015. Most African countries have not been able to meet this target.

2. There are structural problems with Africa's recent growth both on the demand and on the supply side of the economy.

On the demand side, recent growth has been driven mostly by consumption and there has been no significant improvement in average investment rates on the continent over the past two decades. Although consumption is an important source of domestic demand and has been the dominant driver of growth in Africa over the past decade, a consumption-based growth strategy cannot be sustained in the medium to long term because it often results in overdependence on imports of consumer goods, which presents challenges for the survival and growth of local industries, the building of productive capacities, and employment creation. Furthermore, it causes a deterioration of the current account balance, which would have to be corrected or reversed in the future to maintain external sustainability. Experience has shown that reversals of such current account imbalances often require drastic reductions in consumption, which have a severe negative impact on growth. While investment booms can also deteriorate the current account, recent evidence suggests that current account deficit reversals caused by investment booms that increase the production capacity for tradable goods are associated with better growth performance than those driven by consumption booms (Klemm, 2013). There are also structural problems with Africa's recent growth from a supply or sectoral perspective. For example, it has not been transformative. Despite the fact that the continent has had high and steady growth over the past decade, many countries are yet to go through the normal process of structural transformation, characterized by a shift from low- to high-productivity activities as well as a declining share of agriculture in output and employment and an increasing share of manufacturing and modern services in output. Available data indicate that the share of manufacturing in total value added has declined over the past two decades. It fell from an average of 14 per cent in the period 1990–1999 to 11 per cent in the period 2000–2011. Furthermore, the service sector is now the most dominant sector of African economies. Its share of total value added in the period 2000–2011 was about

47 per cent compared to 37 per cent for industry and 16 per cent for agriculture. In terms of dynamics, over the same period the service sector had an average growth rate of 5.2 per cent while agriculture had 5.1 per cent and industry 3.5 per cent. Given the fact that the service sector has the highest growth rate and also has a higher share of total value added, its contribution to growth has been higher than those of other sectors. This pattern of structural change is quite different from what one would expect given the fact that the continent is still at an early stage of development. Usually, in the early stages of development the service sector does not play such a dominant role in an economy. Furthermore, the dominance of the service sector should be of concern because it is driven mostly by low-productivity activities such as informal and non-tradable services. These facts suggest that Africa's recent growth is fragile and is unlikely to be sustained in the medium to long term if current trends continue.

3. Africa experienced a significant increase in the productivity of investment over the past two decades.

The ICOR, which measures the degree of inefficiency in the use of capital, suggests that there has been a significant increase in the productivity of aggregate investment over the past two decades. ICOR is computed in such a way that a higher value for an economy indicates lower productivity. Available data indicate that in the period 2000–2011 the ICOR for Africa was 4.1, compared to 7.4 in the period 1990–1999. This represents a significant increase in the productivity of investment in Africa. The data also indicate that compared to other developing-country groups, the productivity of investment in Africa in the period 2000–2011 was much higher than those of developing countries in America and slightly higher than those of Asia. This represents a big shift compared to the 1990s, when investment was less productive in Africa than in other developing-country groups. While there has been a significant improvement in the productivity of investment at the aggregate level, it should be noted that there were 22 countries in the continent for which the productivity of investment either did not change or declined between 1990–1999 and 2000–2011, indicating that more effort will be needed by African countries to sustain or improve upon the recent increases in the productivity of aggregate investment.

4. The composition of investment matters for growth in Africa.

It is often argued that what matters for growth is private and not public investment. However, results of country-level studies using African data indicate that public

investment also matters for growth in Africa and catalyses or complements private investment. For example, Samake (2008) found that public investment crowds in private investment, and that both types of investment have a significant impact on growth in Benin. Similar evidence has also been provided for Cameroon (Ghura, 1997). Other studies have found that public capital is generally productive and boosts output at the sectoral or national level. An example is the study on South Africa by Fedderke et al. (2006). Additional supportive empirical evidence on the role of public investments in the growth process in Africa can be found in Fosu et al. (2012). These findings confirm the strategic role of public investment in the growth process.

5. Public investment rates in Africa have declined relative to the 1980s and are currently below optimal levels.

Relative to the early 1980s, there has been a significant decline in public investment rates in Africa over the past two decades. In particular, public investment rates fell from a peak of 11.5 per cent in 1982 to about 5 per cent in 2012. Unlike in the 1980s, public investment rates on the continent were relatively stable in the 1990s and 2000s, with the average rate being about 7.5 per cent in each of these two decades. These numbers are below what a recent study suggests is optimal for Africa. For example, simulations of growth models show that the public investment rate that maximizes consumption is between 8.4 per cent and 11 per cent, depending on the discount rates used (Fosu et al., 2012). At the country level, the evidence shows that there was a decline in public investment rates in at least 23 countries over the past two decades, with the most dramatic declines observed in the following countries: in Cape Verde it fell from 18.1 per cent to 13 per cent; in Egypt it fell from 14.5 per cent to 8.2 per cent; in Eritrea it fell from 17.6 per cent to 13.4 per cent; and in Lesotho it fell from 18.2 per cent to 9.1 per cent.

6. There are several binding constraints to investment in Africa that need to be lifted to unlock the potential of investment for transformative growth.

A review of the literature on African economic development suggests that the main determinants of investment in Africa are access to credit and the cost of finance; domestic savings; risk and uncertainty; inequality or income distribution; and the policy and investment environment as reflected, for instance, in the level and quality of infrastructure. Clearly, given the heterogeneity of African countries, the relative importance of these factors varies from country to country. Nevertheless,

the report finds that the most binding constraints to investment in most African countries are weak access to affordable finance, poor infrastructure, and risk and uncertainty.

7. External finance continues to play an important role in financing investment in Africa but its contribution has declined significantly over the past two decades.

African countries have historically used external finance such as FDI, debt and ODA to complement domestic resources for investment and this is evidenced by the fact that the continent has had a positive investment–savings gap over the past few decades. For example, in the period 1980–1989 the investment–savings gap of the continent as a percentage of GDP was 1.2 per cent. More recently, there has been a significant decrease in the gap. In particular, for the period 2000–2011, the continent had a negative investment–savings gap of about 2.8 per cent, reflecting the fact that more investment is financed through domestic sources. Oil-rich African countries exhibit a substantial surplus of saving over investment, with an average ratio of savings to investment of 158 per cent for the period 2000–2012. In contrast, non-oil-rich African economies have a low ratio of savings to investment of 17.2 per cent over the same period. The ratio of savings to investment has increased substantially for oil-rich countries, especially since the 1980s, spiking during oil boom episodes. African countries also depend on ODA to finance investment more than their counterparts in other developing countries. The ratio of ODA to investment over the period 2000–2012 was 68.8 per cent for Africa compared to 23.1 per cent for other developing countries. The gap is even larger for public investment: 239.3 per cent for Africa compared to 84.3 per cent for other developing countries. However, African oil-rich countries appear to rely less on ODA, with a ratio of 34.9 per cent in 2000–2012 compared to 78 per cent for non-oil-rich countries. African countries also exhibit higher ratios of debt to investment compared to other developing countries. There are less distinguishing patterns regarding the FDI to investment ratio. Oil-rich countries exhibit slightly higher ratios, consistent with the tendency for resource seeking observed in FDI to African countries.

C. MAIN MESSAGES AND RECOMMENDATIONS

An analysis of Africa's economic growth over the past two decades suggests that it is fragile due largely to the structural nature of the growth. Against this backdrop, the report argues that sustaining growth for employment and poverty

reduction in Africa in the medium to long term requires structural transformation and that investment is a major driver of transformation. One of the main messages of the report is that achieving sustained and transformative growth in Africa requires broadening the sources of growth on the continent on the demand and supply sides of the economy. On the demand side, this means balancing the contributions of consumption and investment to the growth process. On the supply side, it involves inducing a shift from low- to high-productivity activities both within and across the agriculture, manufacturing and service sectors.

A second message of the report is that enhancing the contribution of investment to growth in Africa requires increasing the quantity of investment, improving the productivity of existing and new investment, and ensuring that it is directed to priority and strategic sectors. In particular, the report argues that increasing the level and rate of investment without enhancing the productivity of such investment over time, and also ensuring that it goes to strategic sectors, will be counter-productive. The report underscores the need for more public investment in Africa, particularly in infrastructure, to catalyse private investment. In this context, it argues that public and private investments are complementary and so the focus of government policy should be on how to exploit these complementarities rather than promoting one at the expense of the other.

The report also stresses that African Governments have to adopt a more coherent approach to promoting investment if it is to play an effective role in economic transformation in Africa. In particular, the report argues that macroeconomic policies should not result in prohibitive interest rates that hinder investment and also that interest rates on government securities should not be so high that they incentivize banks to hold excess reserves and reduce lending to the private sector. Furthermore, it emphasizes the need for African countries to change their approach to promoting FDI because it discriminates against local investors and has negative consequences for local entrepreneurship and investment. African Governments offer generous incentives to foreign investors that put local investors at a disadvantage and go against efforts to promote domestic entrepreneurship and investment. In this regard, there is the need for coherence between policies to promote FDI and those aimed at developing local entrepreneurship.

In addition to the messages discussed above, the report makes specific policy recommendations on how to catalyse investment for transformative growth in Africa. Some of the policy recommendations addressing issues at the national and regional levels are highlighted below.

Boosting the level and rate of investment

The report emphasizes the need for African countries to increase the level and rate of investment and argues that this requires the adoption of a more coherent macroeconomic policy framework that, for example, balances the objective of maintaining price stability with that of promoting growth and employment. It also calls for a reversal of the policy bias against public investment, which has been prevalent in Africa since the 1980s, because public investment, particularly in infrastructure, is urgently needed to catalyse private investment. In this regard, the report encourages African Governments to strengthen efforts to enhance domestic resource mobilization to create fiscal space to boost public investments in infrastructure, particularly in energy and transport where it has been very challenging to attract private sector investment. Some of the policy measures for enhancing domestic resource mobilization include: broadening the tax base by exploiting the potential to increase tax revenue through property and environmental taxes; improving tax and customs administration; developing and strengthening the financial system; and better management and use of natural resource wealth.

Addressing imperfections in credit markets that make it difficult for enterprises to access loans at affordable interest rates is crucial for boosting investment in African countries. In several countries on the continent, access to credit is difficult and commercial banks tend to hold excess reserves rather than lend to the private sector. Furthermore, bank loan rates are so high that they hinder investment. The report points out that one way to reduce the incentives that banks have to hold excess reserves in the form of government securities is to ensure that the returns on such securities are not very high. Reducing information asymmetry between lenders and borrowers through strengthening support for the establishment of private credit bureaux and movable collateral registries will also help. The establishment of partial guarantee schemes can also play an important role in encouraging banks to finance private sector investments. The report underscores the need to enhance access to long-term finance through establishing and strengthening development banks at the national and regional levels. But it cautions that if these banks are to succeed they have to have flexible mandate, operational autonomy, adhere to sound governance and management practices, and have a credible mechanism for assessing performance on a regular basis. It also acknowledges the potential role of capital market development in enhancing access to long-term finance in Africa. For example, it can facilitate the channelling of long-term savings from pension funds and insurance into long-term investments. The report, however, argues that

given the small size of African economies, capital markets are more likely to be effective if they are developed at the regional level.

The report points out that reducing risk and uncertainty facing local and foreign investors is also crucial to boosting investment on the continent. Political instability, macroeconomic volatility, and policy reversals are all sources of risk and uncertainty in Africa and they have negative consequences for investment. For example, macroeconomic instability can lead to large fluctuations in real interest rates and make lending and investment challenging. Addressing the issue of risk and uncertainty will require reducing the incidence of policy reversals, making more efforts to ensure that information on government policies are widely disseminated to the public, reducing macroeconomic instability, and maintaining peace and security. The report points out that reducing uncertainty in monetary policy by, perhaps, tying interest rate changes to movements in real variables such as real output growth or employment can also enhance transparency in policy rate setting, reduce uncertainty and encourage firms to invest in long-term projects. Better information on regulations and rules governing investment as well as investment opportunities will also reduce uncertainty and contribute to promoting investment. Although the primary responsibility to provide information rests with the Government, the media can also play an important role in this area.

Investment demand also depends on the policy and investment environment, as reflected for example by the availability and state of infrastructure. Firms have an incentive to invest if they know that infrastructure is available and of good quality. The state of infrastructure also affects the incentives for banks to lend to the real sector. For example, in countries with severe power outages, banks are reluctant to finance projects in agribusiness and manufacturing because the likelihood of non-performing loans in these sectors will be high. Public investment in infrastructure is therefore important in boosting investment. Other policy recommendations for boosting investment identified in the report include reducing inequality in the distribution of income and assets, and strengthening regional integration and the development of regional production networks.

Ensuring that investment goes to strategic and priority sectors of the economy

There are certain activities and sectors that are critical to building productive capacities and achieving sustained and transformative growth. These include infrastructure and production activities in the agriculture and manufacturing sectors. The national development plans, visions, or frameworks of most African

countries identify these as strategic or priority sectors. However, commercial banks and financial institutions in Africa are generally reluctant to finance projects in these sectors, preferring to lend to the non-production sectors. In this regard, one of the challenges facing African Governments is how to promote investment in the strategic or priority sectors by redirecting financial resources into these sectors. The report argues that industrial policy has an important role to play in achieving this goal. It suggests that central banks can encourage lending to strategic sectors through adopting a refinancing (discount) policy that favours lending to these sectors. The policy involves setting a differentiated discount rate that is lower for bank advances dedicated to financing investment in strategic sectors or activities. Another way to redirect investment to the strategic sectors, particularly in the case of SMEs, is to encourage financial institutions to use the flow of remittances as collateral for SMEs that seek finance for productive investments. The establishment of partial credit guarantee schemes can also increase the flow of funds to strategic sectors and groups such as SMEs. There are also non-financial measures that Governments can take to promote investment in the strategic sectors, one of which is the provision of market information and investment opportunities available in those sectors.

Improve the productivity of investment

Enhancing the contribution of investment to growth and transformation is not about increasing the quantity of investment alone, it is also about improving the productivity or quality of existing as well as new investments. While there is some evidence that at the continental level the productivity of investment in Africa has improved over the past two decades, it is also the case that there are many African countries where the productivity of investment either did not change or declined over the same period. Against this backdrop, the report underscores the need for African Governments to strengthen efforts to enhance the productivity of investment. With regard to enhancing the productivity of private investment the report argues that the development of workforce skills, provision of good infrastructure, enhancing access to affordable credit, and reducing the high costs of factor inputs are ways to address the challenge. With regard to enhancing the productivity of public investment, particularly in infrastructure, the report recommends better project selection and delivery, getting more value out of existing infrastructure through maintenance of assets, and more targeted public investment which could be achieved through refocusing public investment in areas such as energy and transport, which are some of the binding constraints to boosting investment in Africa.

The report points out that while the responsibility for catalysing investment to transform Africa rests with national Governments, there are issues with an international dimension that have a bearing on the ability of African Governments to achieve their development goals. These include FDI, capital flight, aid, and international trade. The policy recommendations of the report in each of these areas are discussed below.

Strengthening linkages between local and foreign enterprises

African countries experienced a significant increase in FDI flows to the continent over the past decade but there are concerns that the developmental impact has been limited due in part to weak linkages between foreign and local enterprises. The report argues that the lack of availability of adequate infrastructure and skilled labour, low absorptive capacity, policy incoherence, and the lack of a vibrant domestic private sector are some factors that are responsible for the weak linkages between local and foreign enterprises in Africa. It recommends that African Governments should create and strengthen linkages through developing and improving workforce skills as well as raising the absorptive capacity of local firms, for example, through the imposition of technology transfer requirements on FDI. It also stresses the need to promote joint ventures between local and foreign enterprises and to make FDI policy consistent with the promotion of domestic entrepreneurship. In this regard, it suggests that African Governments should not promote FDI in a manner that discriminates against local investors. Furthermore, it suggests that if incentives are to be used to promote FDI, they should be used mainly for attracting new investments in activities where a country cannot attract investors without such incentives. For example, in most cases incentives are not necessary to attract FDI in the extractive industry because such investments will take place anyway given the high demand for resources and investor interest in the sector.

Stemming capital flight to boost investment

Africa loses significant amounts of resources each year in the form of capital flight. The report underscores the need to address the problem of capital flight to release more resources for investment in Africa. The report argues that efforts are required at the international, regional and national levels to curb capital flight. For example, international cooperation is required to prevent tax evasion and the illicit transfer of capital across borders. Some measures were taken recently at the regional and international levels to address this issue. For example in

2013 the G8 countries made a commitment to fight tax evasion at the national and international levels. They also committed to introduce rules to ensure that multinational companies do not shift profits across borders to avoid taxes. At the continental level, African regional organizations set up the High-Level Panel on Illicit Financial Flows to advise Governments on the nature and magnitude of these flows and offer insights on how to address the challenge. The report also stresses the need for African Governments to improve tax and customs administration, ensure transparency in management and use of natural resources, and rethink their FDI promotion policy to ensure that multinational corporations that receive incentives do not contribute to illicit financial flows.

Using aid to stimulate investment

The report argues that aid can have a more positive impact on development in Africa if it is geared more towards, for example, stimulating investment through using it as a guarantee mechanism to reduce the risks faced by lenders and investors. Banks are often reluctant to lend to investors because of the risks involved. The use of ODA to provide partial guarantees to banks will encourage them to lend, thereby increasing investment. The report underscores the need for more aid to be channelled to the production sectors to build productive capacities on the continent. The report also encourages development partners to use more aid to lift infrastructure constraints, particularly in energy and transport, as was recently done by the United States through the Power Africa initiative.

Stimulating investment through fostering international trade

African countries can also boost investment through fostering international trade. Access to a larger market through trade will allow African countries to exploit economies of scale associated with producing for a large market, thereby enhancing their competitiveness and stimulating investment. In this regard, the report underscores the need for the international community to grant African countries more market access, particularly in areas such as agriculture where they have currently a comparative advantage. But enhanced market access will be of benefit to African countries only if they have the productive capacity to take advantage of the opportunities arising from such market access. Therefore, the report stresses the need to build productive capacities in Africa and also for better information sharing on available market access opportunities so that African entrepreneurs can take more advantage of these opportunities. The report points out that high international trade costs have a negative impact on trade and investment in Africa and recommends

that the international community provide financial and technical support to African countries to enable them to implement the Agreement on Trade Facilitation adopted by WTO members in Bali in December 2013. It also emphasizes the need for African Governments to have a more coherent approach to the various trade negotiations and agreements they are engaged in to ensure that the outcomes are mutually supportive of economic transformation and development on the continent.

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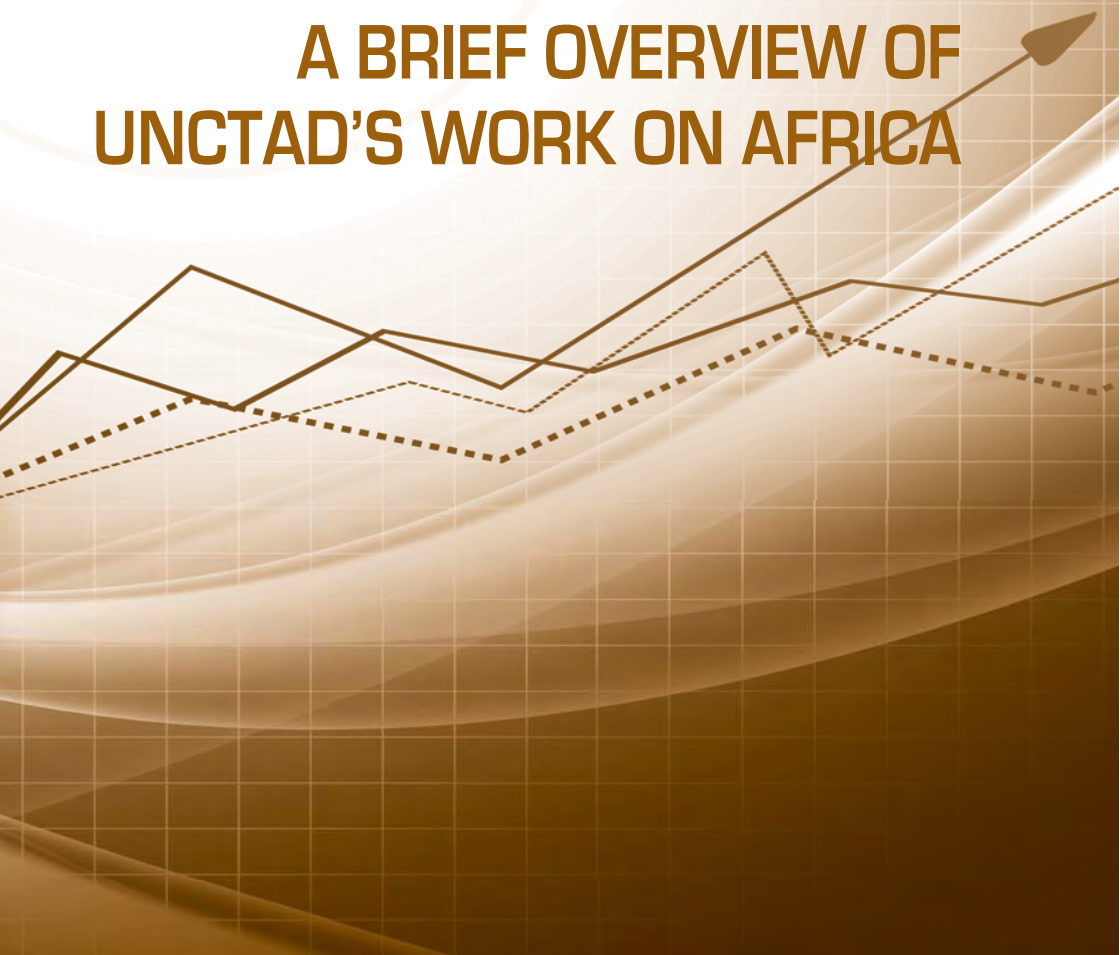
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UNCTAD AT FIFTY: A BRIEF OVERVIEW OF UNCTAD'S WORK ON AFRICA



Since its establishment in 1964, UNCTAD has contributed to economic development in Africa through research, policy analysis, technical cooperation, and by facilitating consensus on global issues affecting Africa's development. In line with its mandate, UNCTAD's support to Africa over the past five decades has focused mainly on trade and development as well as interrelated issues in the areas of finance, technology, investment and sustainable development. For example, UNCTAD has contributed to economic integration in Africa through technical assistance and policy-related capacity-building support to African regional economic communities and organizations. It participated in the work of the committee set up by the Organization of African Unity to draft the treaty for the creation of the African Economic Community. It has also supported the African Union in implementing the Abuja Treaty and its Action Plan for Boosting Intra-African Trade.

UNCTAD's research and policy analysis has played an important role in advancing debate and galvanizing international action on global issues such as the debt problems of developing countries, the challenge of commodity dependence and volatile commodity prices, how to enhance access to export markets for Africa and other developing countries, and mobilizing financial resources for development. UNCTAD's work on Africa has been within the framework of international programmes and initiatives aimed at promoting economic development in Africa. In the 1980s, it contributed to the implementation of the United Nations Programme of Action for African Economic Recovery and Development 1986–1990. It also played a crucial role in the implementation of the United Nations New Agenda for Africa in the 1990s. More recently, UNCTAD's work on Africa has been geared more towards responding to the development needs and priorities of African countries, as reflected in the New Partnership for Africa's Development adopted by African Heads of State and Government in 2001 and ratified in 2002.

Partnership is an important feature of UNCTAD's support to Africa. Over the past decades UNCTAD has strengthened collaboration with African regional institutions and multilateral organizations providing assistance to Africa. It has collaborated with the ECA, the African Union Commission, the African Capacity Building Foundation and the AfDB. It is also a member of the Regional Consultation Mechanism of United Nations agencies and organizations working in Africa in support of the African Union and its NEPAD programme. UNCTAD signed a memorandum of understanding with the African Union Commission in April 2008 and with the NEPAD Planning and Coordinating Agency in January 2014. These partnerships have enabled UNCTAD to enhance the impact of its activities in Africa.

UNCTAD has an established history of conducting policy research and analysis on key economic development issues affecting Africa. For example, in 1990 UNCTAD published a report entitled “Africa’s commodity problems: Towards a solution” in response to a request by the Secretary-General of the United Nations. The recommendations of the report stimulated debate and action on the problems of Africa’s commodity-dependent economies. In 1997 UNCTAD also carried out a major research project entitled “Economic development and regional dynamics in Africa: Lessons from the East Asian experience”. The aim was to examine how the development experiences of successful countries in East Asia could assist African countries in designing strategies to address their development problems and challenges. Furthermore, in 1998, part II of UNCTAD’s Trade and Development Report was devoted to an analysis of Africa’s development needs and challenges. The report was presented to UNCTAD’s Trade and Development Board and led to the adoption of far-reaching policy conclusions by the Board.

Up until 2000, there was no specific unit on Africa at UNCTAD and so research on African development issues was carried out in various divisions. At UNCTAD X held in Bangkok, Thailand, from 12–19 February 2000, member States requested that UNCTAD should, in its work on globalization and development, establish a new subprogramme on Africa. This eventually led to the establishment of an office for Africa and the introduction of a new flagship publication at UNCTAD entitled Economic Development in Africa Report, dedicated to the analysis of economic development issues and challenges facing Africa. Some of the issues that have been addressed by the EDAR over the past decade are highlighted below:

- The EDAR 2013, subtitled Intra-African Trade: Unlocking Private Sector Dynamism examined how to strengthen the private sector to boost intra-African trade. The report argued that for African countries to reap expected gains from intra-African trade and regional integration, they will have to place the building of productive capacities and domestic entrepreneurship at the heart of the policy agenda for boosting intra-African trade.
 - The EDAR 2011, subtitled Fostering Industrial Development in Africa in the New Global Environment, examined the status of industrial development in Africa and provided an analysis of past attempts to promote industrial development in Africa and the lessons learned from these experiences. It also provided a strategic framework for industrial development in Africa and argued that the continent needs a new industrial policy to induce structural transformation and engender development.
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- The EDAR 2010, subtitled South–South Cooperation: Africa and the New Forms of Development Partnerships, discussed the growing relationship between African and non-African developing countries and offered policy recommendations on how these relationships could be managed for better development results in Africa.
- The EDAR 2007, subtitled Reclaiming Policy Space: Domestic Resource Mobilization and Developmental States, examined how to strengthen domestic resource mobilization for development in Africa. It stressed the need for policy space and highlighted the crucial role of a developmental State in promoting domestic resource mobilization.
- The EDAR 2008, subtitled Export Performance Following Trade Liberalization: Some Patterns and Policy Perspectives, examined Africa's export performance after trade reforms and drew lessons for the design of development strategies on the continent. The report offered policy recommendations on how African countries could refocus their development priorities on structural transformation to increase supply and export response to trade reforms.
- The EDAR 2006, subtitled Doubling Aid: Making the Big Push Work, discussed how doubling of aid to Africa could promote development on the continent. It argued that major reforms in institutions and practice of aid delivery are needed to ensure that a “big push” for African development is successful.
- The EDAR 2000, subtitled Capital Flows and Growth in Africa, examined trends and patterns of capital flows to Africa and their implications for growth and development. It also discussed policies that are needed to ensure that aid is effectively translated into investment and growth in Africa.

The research and policy analysis work of UNCTAD has been used to provide technical assistance and policy-related capacity-building support to African countries and organizations. It has also contributed to stimulating debates and galvanizing international action on economic issues that affect Africa's development.

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Investment is a major driver of long-run growth and development. It is necessary to build productive capacities, transform the structure of economies, generate employment and reduce poverty. Over the past decade, African countries have had relatively good economic growth performance. But average investment rates on the continent remain low relative to what is considered necessary to achieve national development goals. They are also low relative to the average rate for developing countries. These facts suggest that Africa's recent growth may be fragile and that it is unlikely to be sustained in the medium to long term if current trends continue. The key question, then, is how can African Governments catalyse investment for sustained and transformative growth? *The Economic Development in Africa*

Report 2014, subtitled *Catalysing Investment for Transformative Growth in Africa*, addresses this issue. It underscores the need to enhance the contribution of investment to growth through boosting investment rates, improving the productivity of existing and new investments, and ensuring that investment goes to strategic and priority sectors deemed crucial for economic transformation. It also stresses the importance of strengthening linkages between local and foreign enterprises, stemming capital flight to release more resources for investment, using aid to stimulate investment and fostering international trade to boost investment. In each of these areas, the report emphasizes the need for policy coherence at the national and international levels.

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