

NEPAD, THE POINT OF VIEW OF AN INTERNATIONAL INVESTOR

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When a multinational firm or any other international investor decides to make a foreign investment faces an initial trade off between investing in a high cost and high credibility country or to invest in a low cost and low credibility country. Of course, there also are many other options in between these two, because many countries can be located around the middle of the two extremes. Nevertheless, to know if a country should be credible or no is a very difficult task, this is the reason why its final decision in this trade off between credibility or risk and cost or reward needs also to take into account a series of other very important individual country factors that are well known to the classic FDI literature and to the individual experience of many multinationals.

The most important of these are the following:

First, its main macroeconomic data: the country's size, measured by its nominal GDP in dollars; its rate of growth, measured by its real growth in per capita GDP; its income level or size of the domestic market, measured by the population and its level of per capita real GDP; its level of investment, measured by its ratio of fixed capital formation to GDP and, finally, its openness, measured by its ratio of trade to GDP.

Second, its microeconomic factors: its level of human capital, measured by the percentage of the workforce with primary and secondary education, as well as the quality of its education, measured by the ratio of students per teacher; its level of health, measured by the ratio of health expenditure to GDP as well as its infant mortality rate and its average life expectancy; its level of physical capital, measured by its ratio of investment in equipment and infrastructures to GDP.

Third, its institutional development, measured by its level of political stability, the effectiveness of its judiciary system, of its level of rule of law implementation, and of its level of compliance of contracts and its level of personal safety and security and its level of corruption.

Finally, it is also an extremely important factor, for the final decision, the past and recent experience of other multinationals that have located previously in the country, if any.

Unfortunately, in many countries of Africa, some of these decisive factors have not been positive enough, in relative terms to other regions, to be able to attract substantial flows of FDI. Moreover, the total lack of credibility of some African countries has precluded others, with much better level of compliance of these factors, from attracting large FDI flows as well. Unfortunately, the negative externalities produced by non-credible countries have created, as a consequence, a certain contagion to the rest of the region and a general perception, by many multinationals, of a "bad reputation" for the continent as a whole.

If it takes a lot of years of a large individual and collective effort for a country to gain or to regain credibility, it is even more difficult for a whole continent. The recent historical experience shows that the only short cut available for gaining faster credibility by a country is to be able to join a "credible club" formed by credible countries. For example, Spain, Portugal and Greece were able to achieve that short cut many years ago, by joining the European Union. More recently, Mexico has been able to "decouple" from the rest of Latin America by joining the North American Free Trade Area. The same is already happening to the Central European countries that are ready to join the European Union in 2005. In all these cases, FDI has started to arrive

quickly and massively into the newly “blessed countries”, once multinationals and financial investors perceived that there is a high probability of them joining those “credible integration clubs”. In other cases, even the mere close vicinity to “credible countries or clubs” has helped to attract reasonable amounts of FDI. This is the case of Morocco and Tunisia, for example. On the contrary, it has been much more difficult for South Africa or Botswana, for instance, to attract the volume of FDI that they deserve, according to their achieved standards of credibility, because of their remoteness from the European Union or any other “credible club” and because the vicinity of disrepute neighbors.

NEPAD, if it achieves a success, has a high chance of reversing the present negative reputation of the whole African continent. Its initiatives of Political, Economic and Corporate Governance, as well as those attempting to improve Peace and Security, Infrastructures, Banking and Financial standards, Human Resource development, Domestic Capital Resource enhancement, Poverty reduction, ODA reform and Market Access are, all of them, focusing, rightly, on improving the credibility of the Continent and, as a consequence, on attracting larger amounts of foreign capital flows.

NEPAD has three very important and pioneer attributes:

On the one side, it is the first serious and viable collective attempt, made exclusively by the same African nations, to overcome their generally low level of international credibility and reputation.

On the other side, it is the first and most serious try, arising from within African countries and without any external pressure or conditionality, to escape from its probable fate of being definitely left out of the present globalization process.

Finally, it is its first effort, ever made in Africa, to introduce clear benchmarks and targets in all the different Initiatives to be achieved according to a pre-established calendar and to periodic, transparent and objective “peer policy reviews”, as well as to internal controls to check and audit their true compliance. This is the reason why it deserves the full international understanding, recognition and help not only by the OECD countries and International Institutions but also by multinationals and financial investors.

The economic rationale behind NEPAD seems to be the following:

First, the only way that the African continent can gain international credibility and reputation is not by joining “credible integration clubs” from other continents, (because this option it its impossible to achieve in any foreseeable future and it will always be a “non starter”), but by creating, collectively, the basis and the methodology to become eventually a credible continent on its own merit. This courageous and inevitable option needs, as a necessary condition, to integrate, as much as possible, the African continent both politically and economically in order to achieve a stronger voice in the international decision making and to reach a much larger integrated market where economies of scale could be fully exploited and transaction costs drastically reduced, by removing the internal barriers among countries in the whole continent.

Second, recent historical experience has shown that, unfortunately, large individual efforts by some countries to achieve international credibility are doomed to failure. The reason for this negative outcome is the following: Multinationals and other international investors invest so little in Africa that they do not find profitable to spend in economic and political research and analysis on the situation of individual countries, therefore, they are no able to discriminate

between credible and not credible countries. They have to rely on newspaper and news agency information which tend to concentrate almost fully on the “bad news” arising from individual disrepute countries and, at the same time and rightly so, they reject any expensive “advertising or propaganda” that almost every African country tries to place in some business media in order to show to the international investing community their economic achievements and successes. As a consequence of this rational behavior by foreign investors, the “contagion effect” in Africa tends to be total. “Bad news” coming from some countries with very little international reputation tend to have a “crowding out” effect over “good news” arising from other countries that are making a huge individual effort to become virtuous and credible. If international investors have shown a consistent lack of ability to discriminate among developing countries in the Asian and Latin American crisis, producing large waves of contagion, and fortunately, only recently have been able to decouple Argentina from Chile and Brazil, where FDI and Portfolio flows are very large, it is unthinkable to avoid full contagion in the African continent where these flows are relatively very scarce.

Third, the NEPAD “Peer Review” process is the key element to avoid contagion. It will start a system of classifying African countries according to their compliance of the different governance standards and will made much easier for a foreign investor to discriminate between a credible and a non credible country and, therefore, it will enhance the probability of the “virtuous” countries, that come out better classified, to attract more national and foreign capital. At the same time, the “Peer Review” will produce a “snow ball effect”. The countries that are left out of the “Peer Review” or that have not achieved a good classification will have an incentive to improve their governance and join the best performers in order to attract more capital as well. This system will develop a process of economic “variable geometry” that will have a very positive effect on the improvement of general governance in the continent by creating the right incentives for the governance compliance laggards to follow the leaders.

Fourth, it is also very important for the success of NEPAD the ability of African countries to come up with concrete regional co-operation projects and joint investments not only to create a “momentum” for its development and to integrate more deeply the economies of the African continent but also to create interesting opportunities for joint ventures with foreign companies and investors.

Finally, African leaders have fortunately achieved the clear and healthy conviction that, in order to attract foreign capital flows, it is a necessary condition to, previously, mobilize their own domestic investment, given that local investors have a deeper knowledge of their individual situation and can discriminate better among credible and not credible countries in the African region. This is the main reason why NEPAD is rightly conceived as a partnership between African governments and African private businesses, where the latter have also an important voice in its development and implementation in order to achieve a real collective success.

The recent experience of FDI flows into the African continent tends to confirm this economic rationale. Africa has been receiving annual FDI inflows of around 8 billion US \$ in the last five years. That amount is only around 4% of the developing countries total FDI inflows and around 0.7% of the world total FDI inflows. In terms of accumulated stock of FDI, Africa reached, in 2000, 95 billion of US \$ that represent only 1.5% of the world total. This percentage has been falling in the last fifteen years. In 1985 it was 2.8% of the total, in 1990 came down to 2.1%, and now is only 1.5%.

The capacity of African countries to attract FDI has been determined mainly by their natural resources and the size of their local markets. Over the years, despite their highly

unstable political and economic environments, Nigeria and Angola have been two of the most successful countries attracting FDI flows because their comparative advantage in oil resources, while there has been an apparent lack of interest by multinationals in other African countries that have attempted to implement policy reforms.

Nevertheless, there have been a few exceptions to this rule. Some small countries, which have been more successful in implementing reforms, such as Mozambique, Namibia and Mali have been able to attract, relatively larger flows in relation to the size of their markets than the rest of the African countries. South Africa has been able to attract larger FDI flows as well, both because of the relatively bigger size of its market, its important mineral resources and its more developed political, institutional and economic governance, but it is very clear that the unstable political situation in Zimbabwe has reduced, through a contagion effect, the potential FDI flows into South Africa in recent years. South Africa is also the only country in Africa that shows large FDI outflows which is a clear sign of being a more mature economy.

What are, according to the international investors, the necessary conditions to be fulfilled by NEPAD in order to be successful?

The international business community is fully committed to the success of NEPAD. It will profit greatly by finding new, more stable, and more credible markets where to expand its businesses and investments. Therefore, it is ready to help building up the necessary expertise and human capital capabilities that such a partnership needs to achieve a successful implementation. Moreover, it is ready to help African governments and business explaining to the international business community at large, through ad hoc international road shows, the contents, methodology and objectives of NEPAD and to tell the successful investment experiences in the region. There are many successful involvements of multinationals in the region, in spite its present bad reputation that can be told to the rest of the international business community by its protagonists. Finally, the international business community is prepared to start investing in those countries that improve their governance according to the "Peer Review", so that they send the right signals and give the right incentives to the rest of the countries to follow them.

It is also very important to explain the clear distinction between the African Union process and the NEPAD one. The first is a necessary condition to the success of the second but not a sufficient one. African Union is about deepening economic and political integration creating a larger market size and a more powerful international voice. NEPAD is about a completely new way of doing things in Africa, both in the political, institutional, economic and corporate governances of the continent, in order to be able to fulfill the following objectives: Reach a larger market access to developed countries; get a larger amount and a more focused and efficient development aid; receive larger inflows of capital, technology and technical assistance and avoid and reverse the present "brain drain" of human capital. Therefore, African Union is about politics and geography and NEPAD is about governance and geometry. They are distinct but very complementary processes, that feed on each other.

The key to the success of NEPAD to gain national and international credibility is going to depend mainly on a proper institutional building of the partnership. The following necessary conditions should be met to achieve it:

First, the new codes and standards of governance should be set by a new and fully African but also independent Institution, whose members should be appointed by African government leaders, after consulting with their national business associations, among

prominent African experts and reputed professionals. The elected members should act and carry their duties without any political interference.

Second, the new governance standards set by this new Institution should be based on those international ones already being in practice in most credible countries.

Third, the same new African independent Institution should conduct the "Peer Review" process for every African country according to the said standards and, later, to conduct the ex-post monitoring and supervision of its implementation and compliance. Such an institution could coordinate the many individual efforts, both public and private, that already exist in many countries, with the aim of achieving more efficiency in improving general governance across the continent.

Fourth, the submission by every African country to be reviewed by such an Institution should be voluntary. The said "Peer Review" would be much more credible, nationally and internationally, if it will start with those countries that feel more confident to obtain a reasonable classification and if it will not force any country to be reviewed.

Fifth, The "Peer Review" should be conducted on a confidential basis and its results should only be released and made official with the consent of the country involved.

Sixth, if the "Peer Review" process is credible, the countries that reach a good review outcome should be, immediately, supported by the national and international business community through larger capital inflows, so that the rest of the countries that have not been able to achieve yet a good review can find a strong incentive to raise, as soon as possible, their governance standards and try to join them as soon as possible. This should be the real trade-off of the NEPAD partnership. If the African countries deliver what they have promised so must do the national and international business community.

Seventh, the same kind of immediate support should come from the International Financial Institutions in the form of larger development aid and finance for development.

What else could be done by the African Union, in parallel to NEPAD, to achieve larger private capital inflows?

First, the African Union could, at the same time, give a new and strong push to the harmonization of the different processes of regional integration, in order to increase nominal and real convergence as well as market access and trade and investment opening. That will help to create larger markets where multinational investment will be able to exploit larger economies of scale and create larger units of production to be used as platforms for exporting to other countries. The market size, with homogeneous rules and regulations, has proved to be an important factor of FDI attraction. The cases of China, Brazil, Mexico, India and others show that size is able to compensate for the lack of other key determinants factors of FDI attraction mentioned above.

That could also help to adhere, with more critical mass of political negotiating power, to the OCDE Multilateral Agreement on Investment, avoiding, as in the past, that individual developing countries could become net losers by joining, given the high conditionality of the Agreement, and, at the same time, try to avoid, as well, the huge proliferation of Bilateral Investment Treaties, that create a lot of confusion to multinationals. Finally, it will be easier, having access to a larger market, to require the multinationals to agree in joint ventures to capture more the benefits that foreign investors have to offer, in terms of technology transfer or

licensing, human capital training, export performance and backward linkages to the domestic industrial base.

African countries have been moving towards Regional Integration partly because they are aiming at tackling obstacles to growth, mainly the smallness of the average African economy and the need to interconnect landlocked countries with their coastal neighbors. But Regional Integration is also attractive as a means to rationalize the continent trade regimes and make trade policies more credible. There are, at the moment, eleven regional trade agreements in Africa. Their acronyms are mind-boggling: AMU, ECOWAS, WAEMU/UEMOA, MRU, CEMAC, ECCAS, CEPGL, EAC, SACU, SADC and COMESA. The first one in North Africa, the following three in West Africa, the next three in Central Africa, the next one in East Africa, the following two in Southern Africa and the last one in East and Southern Africa. The two that have reached a deeper level of cooperation and integration are the two belonging to the Franc Zone and the Southern Africa ones.

It seems very clear that all these regional trade agreements should be stitched together in order to achieved the proposed Pan-African Economic Community, (AEC) in 2001 by the African Union. One single international voice for Africa on trade matters at the WTO will give Africa a very large say in this organization. As of today 37 of the WTO 144 members are African. The relative weight of one single African voice will be of more than 25%, (when it represents less than 4% of world trade) and will undoubtedly achieve much better outcomes for the African exports access to the developed country markets. But in order to have a single voice Africa should also have a common external tariff, otherwise it will very difficult to negotiate as a single entity.

Second, another African important initiative should be the development of a rigorous and transparent policy of privatizations, with an adequate and stable ex-post regulation to avoid market abuse and to increase competition, mainly in infrastructures and public services. That will help to attract larger amounts of FDI, as it has been recently achieved, successfully, in Latin America and in the Central European countries. The new foreign investors in these regions have been able to improve dramatically the efficiency of the companies privatized, by investing large volumes of physical capital and, at the same time, they have attracted other large local investments by suppliers of the necessary hardware to improve them, with the result of increasing employment, technology and knowledge transfers.

Finally, the African Development Bank, with its better knowledge of the individual countries and their regional integration developments, should help to develop a program of investment guaranties for investors in African countries, supported by the existing ones established by the World Bank Group, (IBRD, IFC and MIGA), to protect investors from political risk, currency inconvertibility, expropriation, war, civil disturbance and breach of contract. That initiative could help to attract larger volumes of FDI flows.

How the International Organizations can add to the success of NEPAD?

First, once NEPAD becomes a credible exercise, the OCDE countries should try to agree on a new preferential treatment for investments in Africa. Such an agreement could replicate the successful achievement by the Lome Convention in preferential trade. Such an agreement could help to create the right momentum to foster new FDI into the African continent. Another important step has to relate to Official Development Aid. The recent decision of the EU to increase the present average percentage of ODA in relation to GDP from 0.2% to 0.33%

should be followed by other OCDE countries. Nevertheless, a larger volume of ODA is not a sufficient condition for helping African development. The way ODA is allocated, very often still attached to the sale of goods and services, should be concentrated on the urgent needs of the recipient countries, that is, health, education and training and infrastructures and should have a very high grant portion. Finally ODA should arrive directly to the people who need it most. New channels of distribution are essential, including NGOs. The African Union should play an important role in the improvement of the ODA volume and efficiency.

Second, the UNCTAD through its initiatives such as EMPRETEC, ICAF and IPR, could help, very positively and efficiently, to create the basis for new domestic capabilities of small and medium size companies with larger entrepreneurship, better training, more access to international markets, better knowledge and experience to sign successful international contracts and to negotiate joint venture with multinationals, and finally, a better marketing of the different countries information about investment conditions for FDI. The lack of information about the domestic conditions to attract FDI is huge. Historical experience shows that to improve micro and macro fundamentals is not a sufficient condition to attract FDI. It is also absolutely necessary to make those improvements known given that asymmetry of information available by multinationals on many developing countries, especially on LDC. Those countries need not only to be virtuous but also to make the market fully aware of their virtuosity, to show that it is a better location than other countries for new production sites, to show their positive differences from others. That is, country marketing is no different from product or service marketing. In that sense, NEPAD can be the logical channel of information dissemination to the international investors.

Other joint initiatives developed by UNCTAD and the ICC (International Chamber of Commerce) the first one focuses in the same direction, that is to make essential knowledge about LDC to multinationals and foreign investors, through a good and efficient marketing of their capabilities to attract larger FDI flows. The "Investment Guides" of each LDC will help them to be better known to potential investors, with the guaranty that the information published by them has the support of both a reputed international institution and the world largest association of private companies. The "Investment Advisory Council for LDC countries" is another very promising enterprise. It is necessary to embark on a serious and balanced dialogue between high representatives of international businesses and the LDC in order to know each other's requisites and conditions and to get first hand advise about how to attract a successful and sustainable flow of FDI to these countries.

Third, It is also of high importance to achieve concrete foreign investment proposals in African countries as soon as NEPAD becomes a reality and to avoid missing such an important a unique opportunity to get Africa into the globalization process. Multinationals tend to react very quickly to a first mover into a country and have a remarkable follow-the-leader response. This is the reason why it is so important to "break the ice" and have some positive FDI experiences to show in the African more "virtuous" countries. For that it would be very important to get a consensus among African country leaders and representatives of multinationals to chose the concrete proposal with the highest probability of success. The infrastructure, health and education sectors should be a priority.

Finally, a note of caution is also necessary. The African leaders who have courageously embarked on launching such an ambitious initiative as NEPAD should be aware of its difficulties and its risks. They have created great expectations that need to be met. On the one side, it is not very clear yet the amount of support that they will get from other African leaders once NEPAD shows its "variable geometry" in full, by starting with only a few "virtuous countries"

capable of prove a reasonable governance standards compliance that can be sufficient to get a decent outcome in the "Peer Review" and leaving the rest to follow them through a "demonstration effect". On the other side, if the NEPAD process does not prove to be really independent and exempt from any country political interference, the national and international business community will not buy it. Lets all hope that the African leaders will be ready to overcome, by exercising their leadership and commitment, all the hurdles and difficulties that are going to face to achieve the well deserve success of such an important partnership.

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