Developed country support for growth and investment in Sub-Saharan Africa

Dirk Willem te Velde

FIRST DRAFT

Commissioned by the Commission for Africa

Overseas Development Institute

London

6 September 2004

This paper does not reflect the opinions of the Commission for Africa; any errors are the responsibility of the authors.

Summary of ideas for developed country support for growth and investment in Sub-Saharan Africa.

1. Provide effective duty free and quota free access to African goods in G-8 countries.
2. Eliminate trade distorting subsidies in agriculture markets in the G-8 and compensate African countries for any losses.
3. Facilitate imports of African services
4. Promote outward FDI to Africa
5. Examine effects of investment guarantees in more detail
6. Refocus bilateral investment funds
7. Promote responsible investment abroad
8. Open up developed country borders to temporary movement of African workers
9. Compensate long-run labour exporting countries
10. Facilitate volume and productive use of remittances to Africa
11. Increase aid, particularly in good quality policy environments.
12. Focus on investment related aid
13. Promote business linkages, by financing public goods through the private sector
14. Examine fiscal measures in developed countries on profits related to investment in Africa.

1 Introduction

This note discusses developed country support for growth and investment in sub-Saharan Africa (or just Africa as an abbreviation). It discusses

- Unilateral trade and investment policies (section 2)
- Migration policies (section 3)
- Aid policies (section 4)
- Fiscal policies (section 5)

Investment related measures seem most directly linked to growth and investment, but it does not follow that these are the only measures or the most effective and efficient measures to affect growth and investment. The evidence for some measures relate to trade, welfare or GDP effects. In others it is related to investment directly. This note does not *a priori* assume that investment drives growth, or *vice versa*; rather it assumes that growth and investment are associated and grow together.

Evidence for several measures relates to growth and investment in all developing countries, not just in Africa. Others can be specifically targeted at Africa, but a question remains whether this would be desirable from a poverty reduction point of view given that some LDCs and a lot of poor people are located outside Africa. Further, we focus our attention on what developed countries can do; in some occasions opening up of developing country markets (e.g. Brazil, India, China) to African goods may be just as important. This note does not deal with multilateral funds and policies (UN organisations and Bretton Wood institutions), but developed countries may in certain cases more effectively pool their resources into multilateral initiatives.

2 Unilateral trade and investment policies in developed countries

Provide effective duty free and quota free access to African goods in developed countries.

African countries face trade preferences as part each developed country's general GSP as notified under the WTO, some of which offer additional access through Least Developed status (LDC), through US (AGOA) and European programmes (Cotonou, EBA). The Japanese and Canadians offer African countries (particularly LDC) reduction on MFN (most-favoured nation) tariffs on a more limited range of products. Hence, most African products face zero tariffs in developed country markets, either because these products are (close to) zero MFN products (oil), or because of the above preferences schemes. Granting duty and quota free access by QUAD (US, EU, Japan and Canada) to SSA only is estimated to result in a USD 2.5 billion increase in non-oil exports (14% of total exports; 1% of incomes), much of based on

access to protected Japanese and European agricultural markets[1]. African products face erosion of tariff preferences given expected MFN tariff liberalisation in the future; MFN tariff liberalisation may benefit other (non-ACP/LDC) developing countries proportionally more and even hurt some African countries.

The WTO Agreement on Textiles and Clothing removes textile and clothing quotas in developed countries under the MFA by 2005. Quota removal and lower MFN tariffs will further reduce the SSA share in world trade (though their consumers may benefit from cheaper imports) to quota constrained India and China. SSA countries are less competitive, but AGOA offers opportunities to be used before quota preferences erode and before tariff preferences erode further beyond 2005.

Developed countries can support developing countries in their effort to comply with standards and rules of origin required for developing country exporters to make effective use of existing preferences. Decades of trade preferences show two points regarding Africa's access to world markets:

1. Despite trade preferences offered to ACP and LDC Africa, their *share* in developed country imports has not increased (though current preferences may have raised annual LDC exports by more than USD 3 billion). This suggests a lack of appropriate and good quality capabilities, infrastructure and regulatory environments to export the right type of (diversified) products.
2. Some trade preferences are not utilised. Some early studies indicated that products where EBA offers better access than Cotonou take-up of preferences amongst African LDC ACP in 2001 (except for sugar) was low. This suggests that it is difficult to actually use or switch to using different trade preferences. The various requirements on (cumulation of) rules of origin (tighter under EBA than Cotonou) do not make the situation easier. However, more recent studies including by Stevens suggest that take up of preference *is* high. Regarding the US, while 76% of AGOA exports enter the US market duty free (AGOA, zero MFN or GSP), 62 per cent of US clothing imports does not use the AGOA eligibility for duty free access even though MFN tariffs are high, with peaks. This does suggest a problem in complying with rules of origin.

Eliminate trade distorting subsidies in agriculture markets in the G-8 and compensate African countries for any losses

There are substantial farm subsidies in developed countries (US, EU and Japan), at the cost of developed country consumers and non-developed country producers such as Brazil and Thailand. Unlike import duties, domestic support and export subsidies cannot be reduced preferentially, say for African producers only. Some food subsidies and quotas in developed countries

[1] Ianchovichina, E. A. Mattoo and M. Olarreaga (2002), 'Unrestricted Market Access for Sub-Saharan Africa: How Much Is It Worth and Who Pays?', *Journal of African Economies*, 10, pp. 410-432.

actually protect some Africans (and other ACP) exports and secure lower prices useful for food importing countries (e.g. Nigeria and Senegal) – domestic support in developed countries keep prices of agricultural products low, while high import tariffs in developing countries keep them high. Few SSA countries can afford to offset higher prices by lower import barriers due to a loss in tax revenues. While SSA is a net food exporter (USD 2 billion in 1999), many individual countries are not. Some Southern Africa sugar exports are guaranteed a high price and quota in the EU and would suffer from quota removal. A price cut of 25% of EU sugar translates into a Euro 140 million income losses for the Southern African sugar sector.

But liberalisation in some agricultural products will provide win-win situations for Africans and others. Cotton subsidies in the US (worth USD 3.7 billion in 2001) and EU (USD 0.7 billion) depress cotton prices (estimates range from 10-50%, with 20% a sensible guess when comparing subsidies to world cotton production worth USD 20 billion) and thus export opportunities particularly for (West) African cotton farmers worth around USD 250 million a year (more exports for higher prices), though other exporters (e.g. Australia and Uzbekistan) may gain more. Liberalisation of groundnut markets elsewhere would benefit exporters in Senegal and Nigeria. Developed country export subsidies for dairy products may hurt African domestic and possibly export markets. Thus removal of agriculture support in developed countries will benefit some and hurt others. It is important that the losers be compensated in order to progress on trade liberalisation.

Pro-poor growth in Africa will depend mainly on growth and investment in agriculture in which many African countries have a comparative advantage (although it can not be the only source; countries do not seem to become rich on the basis of agriculture alone). It is important that African agriculture products have access to developed country markets. It is a telling sign that the CDC (Capital for Development) group with a quarter of its portfolio in Africa moved into sectors other than agriculture. The position of the agriculture sector in the portfolio has weakened in the past decade. Agribusiness was 16% of the portfolio in 1972, rose to about half in the early 1990s and then slumped to 11% in 2002. The former CDC group has incurred substantial losses on the portfolio in agriculture (it is worth 28% in terms of original costs) and it often points to developed country protection as one reason for not investing more in agriculture.

Facilitate developed country imports of African services

Offshoring of services and hence possible exports of services for developing countries are not helped by protectionist feelings in developed countries, particularly in the US (and other Anglophone countries). Counteracting protectionist feelings may be difficult but rich countries can help here through public provision of good quality information. This can help to debunk the myth that offshoring leads to loss of jobs in the home country in the long-run. Research has shown that offshoring of services has a positive impact on productivity, growth and employment in the long run in the countries that offshore (whether rich or poor) and those that provide offshored services. The

advantages apply to both user and provider – it is a genuinely positive sum game. Recent economic indicators for industries affected by offshoring often point upward (e.g. the call centre industry in the UK at present). The international community can also help by supporting growth and investment in services capacity in developing countries. It can promote trade in the services sector by improving the regulatory framework including support for the development of data protection rules. And it can promote capabilities for more competitive services. Unlike sector-specific international organisations for agriculture and industry (FAO and UNIDO), there exists no organisation to collect relevant statistics and report on the state of services in developing countries (though the World Tourism Organisation and some other specific sector organisations collect their own data).

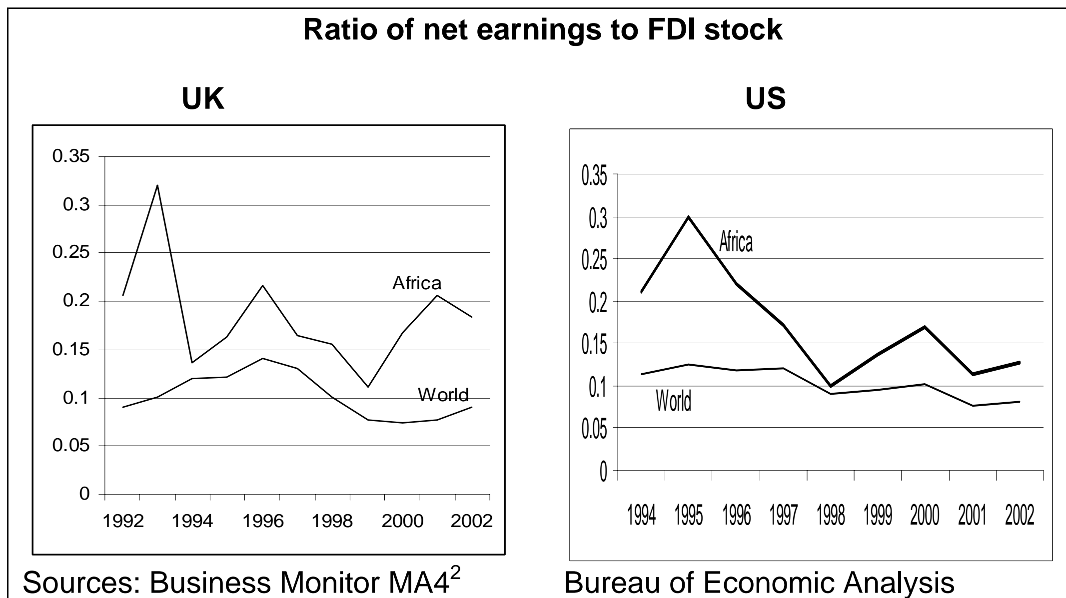
Promote outward FDI to Africa

Surveys of investors seem to indicate that investment perceptions sometimes suffer from the neighbourhood effect that investors in a country will be affected when the situation in a neighbouring country is unstable (e.g. Zimbabwe affecting its neighbours). Or, when parts of Africa are in conflict investors may think that there are no profitable opportunities elsewhere in the region. In reality, there are profitable opportunities in Africa and growth experiences differ widely:

- Profits on (UK and US) FDI are higher in Africa compared to all foreign countries, although differences in risk premia will explain part of this difference. African profits on UK FDI consist mainly of mining and oil/gas profits (£746 million 2001) but also include profits on several other activities such as food products (£375 million 2001), retail and wholesale trade (£585 million 2001) and financial services (£200 million 2001).
- Growth has been sustained for two decades in a number of countries (Botswana, Uganda, Cape Verde, Mauritius, Ghana); GDP per capita has grown in real terms over the last five years in three quarters of African countries. On average, African GDP per capita has increased in real terms in each year since 1998.

If investment opportunities are still misunderstood (notice the big IF, because it would assume that the public sector would be able to distribute information more efficiently than the private sector), investment fora would help to reduce the information gap in home countries surrounding an investment in Africa and reduce the need for superficially high ex-ante, risk unadjusted rates of return. Certain types of information could help to realise profitable opportunities, although from the raw figures it is not clear whether it needs to be tailored to sectors and investors or certain types of information such as on political risk ratings or commercial opportunities. The provision of information has public goods aspects (it benefits many firms, while might be too costly for individual firms to obtain). The provision of information can also have spillover effects when the investment by one multinational is followed by other investment. Expanding of outward promotion activities in Africa (just 6% of UK official staff working overseas to promote UK exports and investment are located in Africa) in co-ordination with African investment promotion agencies

would be useful. It is important that various promoters of outward investment (within and across countries) join: investors are often interested in a package of measures on offer.



Ratio of net earnings to FDI stock

Sources: Business Monitor MA4[2] Bureau of Economic Analysis

Examine effects of investment guarantees in more detail

Political risks may deter investments, particularly in countries with frequent policy reversals. Theodore Moran defines political risks as 'threats to profitability that are the result of forces external to the industry and which involve some sort of government action or inaction'. There is a perception that political risks (of expropriation, war and breach of contract) are particularly great in sensitive sectors such as infrastructure and energy and mining, where investments involve large sunk costs and where host-country governments may be weak and may be forced to breach their part of the contract; also, these are areas that government wants to control. A foreign investor can manage political risks in a number of ways, one of which is to insure against political risks by purchasing public insurance provided by home countries, e.g. ECGD in the UK.

In reality, coverage of investment exposure in Sub-Saharan Africa is low (6% of total investment exposure of the UK ECGD). In addition, there is little evidence to suggest 1) that guarantees are effective in raising additional FDI to Africa and 2) that FDI which has been 'pushed' by guarantees leads to real development in host-countries. Research would thus need to examine whether, and if so, which activities would benefit (or have benefited) from attracting financial flows ahead of the need to build up 'real' economic factors surrounding investment projects. 'Seed' capital might be important to kickstart

[2] Net earnings equal profits of foreign branches plus United Kingdom companies' receipts of interest and their share of profits of foreign subsidiaries and associates. Earnings are after deduction of provisions for depreciation and foreign taxes on profits, dividends and interest.

certain activities and investment guarantees can underwrite such capital lending.

The power and water sectors are the main users of ECGD risk insurance, partly because these sectors involve high upfront investment costs and a long payback period (with receipts in local currency running the risk of default in case of a devaluation); however, the environment for foreign water investors is not favourable at present. Several manufacturing and services sectors tend to involve smaller sunk costs, face fewer risks and require less political risk insurance. The oil and gas sectors also tend to be low users of political risk insurance, despite their importance in UK FDI stocks, suggesting that they design alternative political risk mitigation strategies. In fact, many oil companies have invested for decades and may build on that experience to mitigate risk.

Refocus bilateral investment funds

Bilateral funds include the former CDC group (of which UK DFID is the sole shareholder) and its equivalent organisations in other (grouped) countries including the Investment Facility of the EIB. Some are specifically focused on Africa; a quarter of CDC's portfolio was in Africa, see appendix. Bilateral funds are increasingly under pressure to be self-financing: the CDC group was partly privatised and the Investment Facility at the EIB needs to act as a revolving fund. The rationale is that such funds or equity investors would be better off financing profitable firms (as opposed to subsidise unprofitable ones); however, it is far from certain whether the achievement of mainly financial targets (combined with some geographical targets) will actually achieve economic development, poverty reduction in Africa as well as leverage in private investment. It seems as if such public funds fall between the objectives of leveraging in private sector finance (though it should be noted that there are a handful of successful cases) and stimulating economic growth and reducing poverty, with the risk of achieving neither. It is not immediately clear what a renewed focus would be, and how that could be achieved.

Promote responsible investment abroad

Developed countries can try to raise the development performance by asking their multinationals to comply with the OECD guidelines for multinational enterprise. There is movement in the area of corporate social responsibility and companies themselves are beginning to think more actively about their economic and social impacts. There has also been a rapid emergence of socially responsible investment funds but it is not clear how much this will actually change firm behaviour without engaging more actively with firms or whether it will sacrifice investment volumes to Africa.

3 Migration policy in developed countries

Open up developed country borders to *temporary* movement of African workers

The effects of special and differential treatment for *goods* on African countries are eroding because of multilateral trade liberalisation. However, African regions can ask for special treatment in the area of *services.* African exports of services are increasing, but much has focused on Tourism (e.g. Kenya and Tanzania), while further exports of services, in particular delivery in developed countries, are constrained by WTO GATS mode IV (movement of people) restrictions and other domestic regulation and standards in developed countries.

Many African countries have a comparative advantage in labour and would benefit from migration possibilities; however, there are significant barriers for African labour to move to developed countries. Winters finds that an opening of developed countries to allow temporary entry by foreign workers, equal to three percent of the current workforce, would generate welfare (real-income) gains that exceed those from full merchandise trade liberalisation. If developed countries permitted movement of labour up to 3 percent of the total labour force, world incomes would rise by $156 billion. Developing countries would be the main gainers and the net welfare for the region Africa would be $14 billion.[3] In practice facilitation of temporary movement of natural persons needs to move beyond allowing entry in services trade agreements (mode IV in WTO GATS or as part of EPAs), by facilitating movement through recognising foreign titles and qualification and reducing economic needs test.

Compensate long-run labour exporting countries

Due to staff shortages, developed countries benefit from long-run immigration of nurses, teachers etc. Long-run emigration is likely to lead to losses in human capabilities ('brain drain'), particularly in small developing countries where labour markets cannot react easily. In 2001/2002 alone, more than 2000 nurses emigrated from South Africa to the UK. As developed countries benefit from this immigration and are apparently unable to prepare relevant workers domestically, developed countries could compensate nurses, teachers and other labour exporting countries through transfer of technology, skills and financial assistance. In particular they can set up training centres in developing countries.

Facilitate volume and productive use of remittances to Africa

Once developing country workers have emigrated to developed countries, the loss of human capabilities in developing countries will need to be addressed and the use and volumes of remittances enhanced. Total remittances to developing countries amounted to US$ 80 billion in 2002, about 50% more than official aid flows. Remittances to Sub-Saharan Africa were US $ 4.1 billion in 2002 (US$ 2.1 billion over 1991-2000), compared to US$ 19.4 billion in gross aid and US$ 7.8 billion in net inward FDI. The impact of remittances can be high, especially for small countries whose labour force tend to

[3] Winters, L.A. (2002) , 'The Economic Implications of Liberalising Mode 4 Trade' , paper prepared for the joint WTO-World Bank symposium on 'The movement of natural persons (mode 4) under the GATS', WTO, Geneva, 11-12 April 2002

emigrate in larger proportions (Lesotho, 26.5% of GDP; 19% in Eritrea, 13.6% in Cape Verde; Uganda, 8.5%; 6 per cent in Comoros); much is spent on consumption and a small proportion is spent as investment.[4] Not all remittances are North-South; in fact, the contrary applies to such countries as Lesotho. Nevertheless, the developmental impact of remittances from developed countries to Africa can be high, and such remittances should be encouraged including through a reduction in sending costs and an increased involvement of the African diasporas. The developmental impact of remittances needs to be seen against the loss in human capabilities in sending countries.

Some suggest that 40% of Sub-Saharan Africa's domestic savings together with 40% of African skills is currently based outside the continent. There are some obvious cross border co-ordination failures related to cross-border capital-skill complementarities. Targeting the African's diasporas for foreign direct investment, remittances as well as skills needs a co-ordinated approach.

4 Developed country aid in Africa

Increase aid, particularly in good quality policy environments.

There is a large literature on aid, growth and investment. Burnside and Dollar[5] argue that aid has no effect on growth once other factors have been accounted for including economic policies. Aid raises growth only in countries with "good" policies as this would avoid that governments would waste aid on consumption. Hansen and Tarp[6] use different econometric specifications and find that aid is effective and that the results do not depend on policy.

Two studies are related to aid and growth in Africa. McPherson and Rakowski[7] use a multi-equation system and find that the impact of foreign aid on GDP per capita growth is positive but indirect through investment. Also emphasising that aid affects growth through investment, Gomanee, Girma and Morrissey[8] find that each one percentage point in aid/GNP contributes one-third of one percentage point to growth on the basis of 25 sub-Saharan African countries over 1970-1997.

In 2002 aid to Sub-Saharan Africa amounted to US$ 19 billion, while GDP was US$ 320 billion, implying an aid-GDP ratio of 6%. A doubling of aid would raise growth in Africa by between 1 (McPherson and Rakowski doubling aid would raise investment by 6% which would raise GDP by around 1 per cent)

[4] Sander, C. and S.M. Maimbo (2003), 'Migrant Labor Remittances in Africa', *Africa Region Working Paper Series* 64.
[5] Burnside, C. and D. Dollar (2000), 'Aid, Policies and Growth.' *American Economic Review*, 90, pp. 847-868.
[6] Hansen, H. and F. Tarp (2001), 'Aid and Growth Regressions', *Journal of Development Economics*, 64, pp. 547-570.
[7] McPherson, M.F. and T. Rakovski (2001), 'Understanding the Growth Process in Sub-Saharan Africa: Some Empirical Estimates', *African Economic Policy Discussion Paper*, Harvard University
[8] Gomanee, K., S. Girma and O. Morrissey (2002), 'Aid, Investment and Growth in Sub-Saharan Africa', paper prepared for the 10th General Conference of EADI, Ljubljana.

and 2 percentage points (aid from 6% to 12% of GDP in Gomanee *et al*, model). Below we suggest that a detailed focus of aid is important for investment and growth.

Focus on investment related aid

Offering investment related (but not tied, of course!) aid to developing countries is one of several home country measures that developed countries can put in place to support investment in developing countries. Investment-related aid can support structural economic fundamentals and investment-related governance necessary for investment projects by overcoming market failures in the market for skills, technology and capital in *host*-developing countries. Increased growth (prospects) and improved fundamentals can make individual projects more profitable, helping to attract local and foreign investment.

According to one definition, investment related aid consists of aid in selected categories in

- infrastructure,
- macroeconomic stability,
- legal and policy frameworks,
- private sector support and
- human resource development

Investment-related UK (bilateral) aid has increased both in value and in share of total (bilateral) aid since the 1970s. The share of investment related aid has increased from 18% in the 1970s to 30% at present. Investment-related aid has shifted away from infrastructure towards macroeconomic stability, legal and policy frameworks and human resource development and institution building, which includes provision of public goods (e.g. legal and policy framework and human resource development). A preliminary analysis of UK FDI in 32 non-OECD countries at the macro level indicates that average UK bilateral aid *flows* over 1997-2001 are correlated with *changes* in UK FDI stocks over the period 1997-2001. The correlation coefficient is positively at 0.41 and significant at the 5% significance level.

Distribution of total UK bilateral aid by sector, *percentage*.[9]

	1973-1979	1980-1989	1990-1996	1997-2002
Investment related aid	**18**	**25**	**33**	**30**
Infrastructure	10	13	13	6
Macroeconomic stability	0	8	6	7
Legal and policy frameworks	0	0	2	3
Private sector support	2	3	4	3
Human resource development	6	1	9	11
Other aid (e.g. humanitarian)	**82**	**75**	**67**	**70**

[9] See Velde, D.W. te (2003), 'Home Country Measures and Foreign Direct Investment in Developing Countries,*Identification,trends and breakdown of UK HCMs*, draft; classification based on WTO (2003), 'Overview of technical assistance and capacity building activities related to FDI', Communication from the European Community and its member states, WT/WGTI/W/163.

Investment-related aid for general governance (managing investment flows, the negotiation process and project revenues) could be regarded as a useful developed country support. This may also help countries to avoid the curse of natural resource abundance. One example of investment related aid shows that multinationals involving big FDI projects need strong (public) negotiating counterparts helped by aid. A big mining investor argued that, while multilateral finance was useful though not critical in investment going ahead but that multilateral assistance has been particularly helpful in negotiation and governance issues surrounding the realisation of mega projects such as Mozal in Mozambique. The provision of information (surveys, feasibility studies) was also considered useful.

Investment related aid that focuses on support for institutions should be helpful in setting an enabling environment that generates growth. Good institutions that drive growth are associated with situations where[10]

- investors feel secure about their property rights
- the rule of law prevails
- private incentives are aligned with social objectives
- monetary and fiscal policies are grounded in solid macroeconomic institutions
- idiosyncratic risks are appropriately mediated through social insurance
- citizens have recourse to civil liberties and political representation.

It is often noticed that investment related aid in infrastructure and human resources is helpful in benefiting from and responding to the challenges of globalisation. In this context, it is worrying that UK aid for infrastructure has decreased over the 1990s while the share of human resources in total aid remained constant; in particular, there are increasingly signs that the private sector is not stepping *en masse* into African infrastructure projects (except e.g. telecommunications), although monitoring and explaining trends requires more detailed attention.

Promote business linkages, by financing public goods through the private sector

There is a danger that investment related aid is not always relevant to the specific needs of the private sector. To avoid this mismatch, the provision of investment related aid in the form of (impure) public goods may go through the private sector. The box below argues for a global linkage fund with global co-ordination, but local implementation. The fund should be consistent with private sector development programmes in developing countries and involve local institutions (e.g. Investment Promotion Agencies in the case of linkages between local firms – multinationals).

[10] Rodrik (2004), 'Getting Institutions Right', *Harvard University draft.*

Box Global Linkage Fund[11]

The **objective** of a GLF would be to improve the social dimension of investment (including FDI) by providing opportunities to sustain people's livelihoods in developing countries, especially of poorer people.

The **reasoning** behind the GLF is that it is expected

- To raise investment in developing countries. More efficient linkage possibilities should pull more investment into developing countries by increasing the private and social rate of return of such investments.
- To make investment work for host-country development, in particular for the poorest, by stimulating smaller firm performance through benefiting from reciprocal externalities through linkages with larger firms, e.g. multinational subsidiaries.

The suggested **methods and instruments** are as follows

- Developed countries will support financially the creation of a GLF to promote linkages between large firms and local, smaller firms. Current bilateral funds addressing business linkages include a £18 million fund by UK DFID and a €40 million fund by Germany GTZ (around £25 million). A polled fund would support private sector development programmes of individual developing countries.
- Clear criteria should explain when the private sector (firms, associations) can draw on the fund. This can include
  that intervention in linkage creation should achieve development objectives,
  that it provides public goods that address market failures
  and that it be demand led.
- In practice it may be difficult to score top marks on all criteria. Some flexibility in achieving minimum but not top marks on all criteria could be balanced with sufficient private sector interest or a minimum private sector contribution.
- Activities include supplier development through certification, general training, infrastructure development, provision of information, supporting governance structures, etc. These activities, which feature public goods aspects, are conducive to linkage creation but they are relatively costly for, and discriminate against, smaller local firms. Activities can be done by businesses or through business associations.
- It would address well established firms as well as new investors who may have relatively poor information about local sourcing opportunities and by financing part of finding and developing local supplies could help to attract more investment. There could also be rules that ensure that poorer developing countries have more "right" to draw on the fund (this needs to be defined but rules should be more flexible than inefficient, fixed time periods).

Sectors important for linkage promotion in Africa include

- Agriculture linkage with manufacturing and tourism companies in developing countries. The African agriculture sector is often assumed to be inefficient; there are currently underused linkages between indigenous agriculture and food and beverage manufacturing (e.g. beer companies failing to sources raw materials locally) and with hotels and restaurants (e.g. Hotels importing agricultural goods).
- The manufacturing sector in Africa faces tariff erosion. In particular, the clothing sector was built up with tariff preferences (e.g. AGOA), and this needs an efficient textile sector in order to withstand competition from

[11] Adapted from Velde, te D.W. (2002), "Promoting TNC-SME linkages" presented during ODI lunch time seminar at ODI, 5 December 2002.

China, if at all. African countries need to build dynamic comparative advantages by investing in a textile sector with well developed linkages with the clothing sector (or the erosion of tariff preferences will need to be compensated in some other way).[12]

- The offshoring of services from developed countries (call centres, IT programming, design, health and legal administration, flight booking, etc.) has emerged as a trend of job relocation to developing countries. While India is the frontrunner in providing IT enabled services from developing countries, countries such as Ghana and South Africa are beginning to attract call centres while francophone African countries (e.g. Senegal) are also providing offshored services. The development of good quality and efficient linkages between developed countries and developing country firms depends on data protection guidelines, and on general as well as specialised infrastructure.

5 Fiscal policy in developed countries

Examine fiscal measures in developed countries on profits related to investment in Africa.

The US Commission on Capital Flows to Africa 2003 followed Hufbauer and Wong[13] by suggesting a 10-year exemption from US taxation for *bona fide* FDI income earned by a registered subsidiary or branch doing business in any African country, provided that the country meets two simple tests:

- The host country should respect human rights and disavow terrorism, as certified by the US State Department.
- The host country's tax and regulatory systems should not discriminate against US investors, as certified by the U.S. Treasury.

It is estimated that about 1.6 billion of total of 4.6 billion earnings is repatriated to the US which would under the new rules be exempted from an additional 15% tax, worth around US$ 240 million in lost revenue to the US treasury. It is expected that US tax exemption, in conjunction with African tax reform, will succeed in reducing business taxes by 10 percentage points, which would raise the USFDI stock in Africa by 20 percent. The additional US$3 billion of USFDI was estimated to boost African GDP by US$1.2 billion annually (this is a cost benefit ratio of 1 to 4).

[12] For one existing examples of linkage promotion in the African manufacturing sector, see SMEELP (Mozal's Small and Medium Enterprises Empowerment and Linkages Programme) which has awarded successfully 28 packages to 16 local companies, using US$ 5 million; 36 SMEs have attended training programmes. The Mozambican Centre for Investment Promotion assessed and recommended suitable capabilities in local SMEs. SMEELP has been handed over to MOZLINK of CPI. The IFC and the Mozabican government were both involved.

[13] Hufbauer, G. and Y. Wong (2002), 'Tax Relief for Investment in Africa', *Corporate Council on Africa Discussion Draft*, IIE.

In the UK, total net earnings (profits of foreign branches in Africa plus United Kingdom companies' receipts of interest and their share of profits of African subsidiaries and associates) after deduction of provisions for depreciation and foreign taxes on profits, dividends and interest amounted to £2 billion (or US$ 3.6 billion) in 2002 compared to a UK FDI stock of £11 billion (or US$ 20 billion). Not all of these profits are likely to be repatriated, and it is not clear how much earnings on UK profits abroad are taxed in the UK.

The effects of tax concessions will thus differ by country. For instance, the UK and Netherlands operate a different tax system from that in the US. It would however be relevant to assess the effects of similar tax exemptions in other developed countries. Will tax exemptions be expected to be as effective in stimulating FDI and stimulating host country economic activities as those in the US (key elements are how much the effective tax rate would decrease and how much economic activity would increase as a result)? What would be the administrative costs for fiscal authorities (e.g. the costs are at least 1 penny for each pound collected in UK corporate tax revenue)? Would it be possible to administer corporate tax exemptions on a country (as in the above US proposal) or country by firm basis (if certain firms would be exempted because of their benefits for development)?

6 Conclusions: Supporting Growth and Investment in Africa

We have discussed in very general terms various measures that can be put in place by developed countries to support growth and investment in Africa.

- Trade measures such as facilitating imports of African goods and services (standards, rules of origin, recognition of foreign qualification, etc) continue to be important, but they are not simply reducing import duties as African countries face tariff preference erosion instead.
- Investment measures addressing information failures still seem required.
- However, more important for growth and investment seems the provision of investment related aid, in areas such as
    - Infrastructure where the private sector has not filled the gap from where the public sector has withdrawn over the years;
    - Human resources development which is also important in reacting to and benefiting from globalisation;
    - Institutions and governance surrounding investments, in particular large scale investments; and
    - Business linkage promotion.
- Fiscal measures may be important in certain developed countries
- More open and effective developed country migration policies, brain drain issues and issues related to facilitating remittances are potentially important for growth and investment in Africa, but are only beginning to be discussed.

Most measures relate to several departments within a country and hence there is a clear need for co-ordination.

Appendix: Examples of UK home country measures in Africa

CDC's equity investments (2001)

Country /region	Invested £mn
Africa (not specified elsewhere)	31.1
Côte d'Ivoire	12.9
Ghana	10.5
Kenya	36.2
Malawi	1.1
Mauritius	7.0
Mozambique	1.7
Namibia	1.6
Nigeria	1.7
South Africa	52.7
Swaziland	12.9
Tanzania	28.0
Uganda	3.8
Zambia	36.3
Zimbabwe	15.9
Total Africa	253.4

Source: IDC minutes

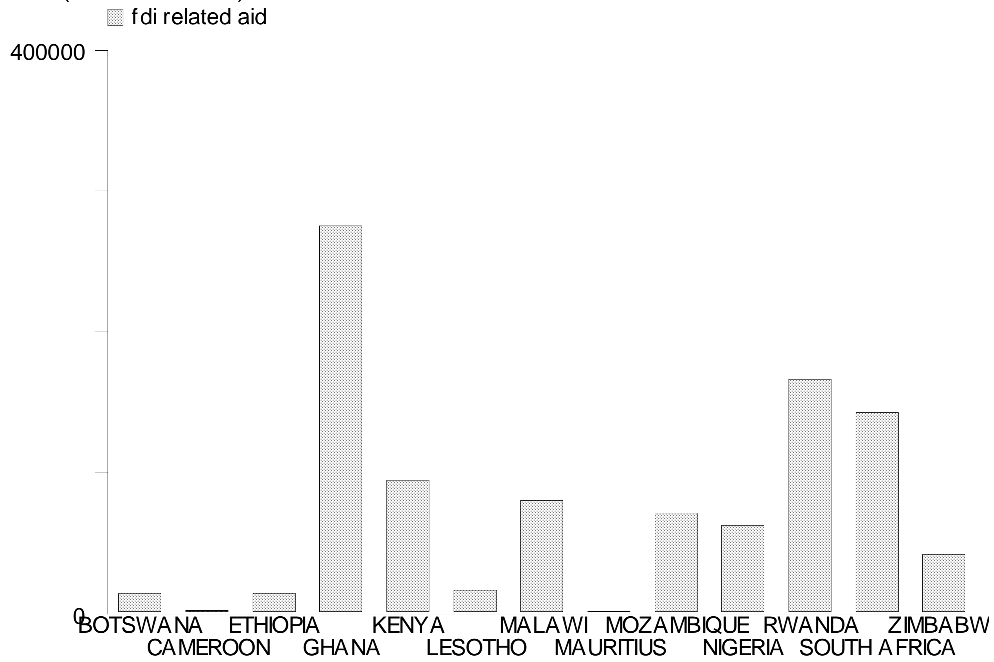
ECGD Overseas Investment Insurance (£mn)

	1996	1997	1998	2000
Ghana	4.96	11.17	9	
Kenya	4.5	4.5	4.5	
Malawi	3.67	3.67		
Nigeria	23.18			
Rwanda	0.71			
South Africa				50.5
Zimbabwe	0.2	0.2	0.2	0.2
SS Africa total	37.22	19.54	13.7	50.7
Total	204.98	335.44	520.4	796.83
SSA share of Total	0.181579	0.058252	0.026326	0.063627

UK FDI related aid, by country, *US$1000* 1997-2002, if >US$ 1mn, OECD-CRS commitments

Africa

scale: (0, US$40mn)



(cont.)