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A BETTER INVESTMENT CLIMATE IN AFRICA

Business views

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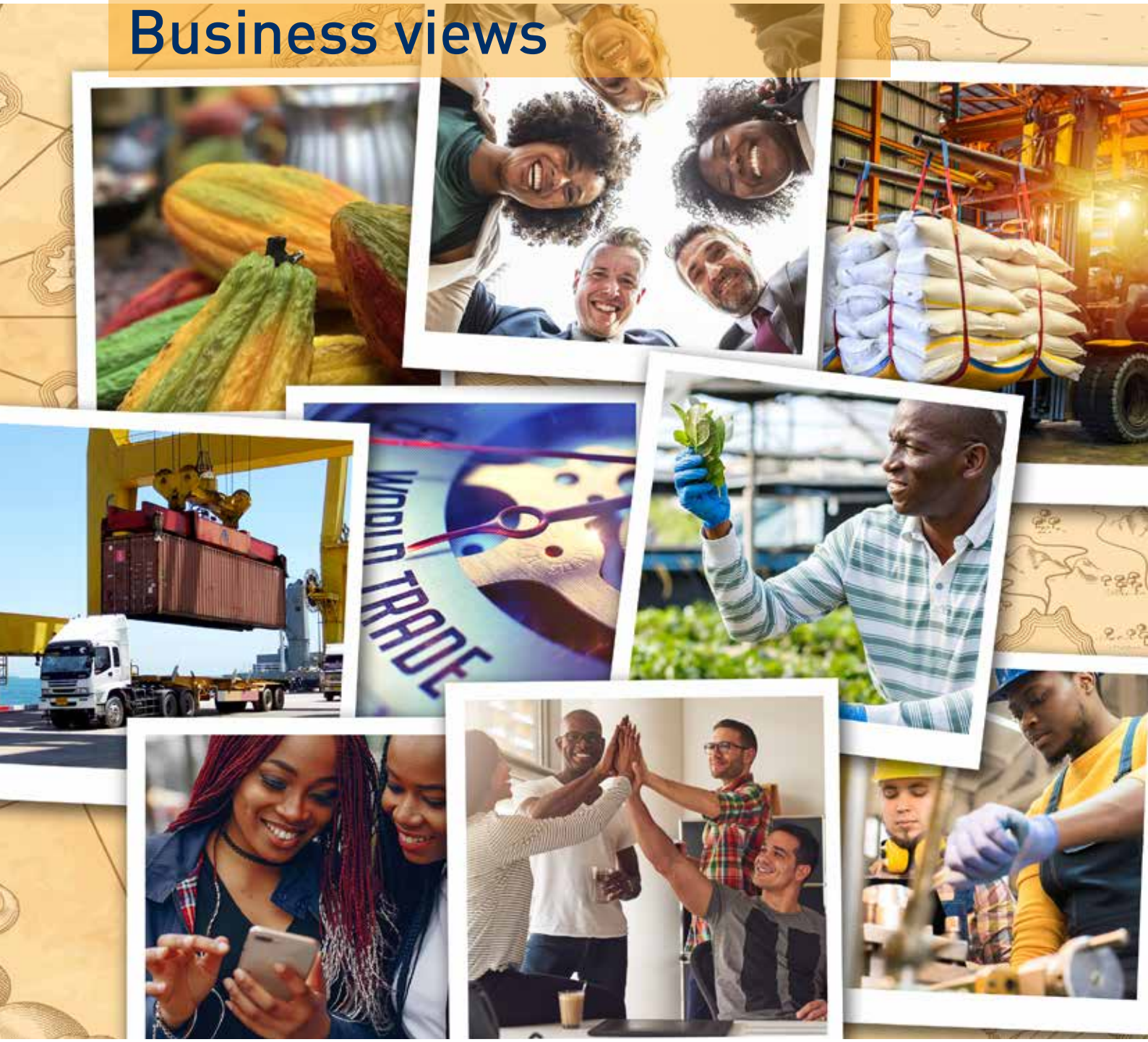

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WHO ARE WE ?

BusinessEurope is the leading advocate for growth and competitiveness at the European level, standing up for companies across the continent and campaigning on the issues that most influence their performance.

A recognised social partner, we speak for all-sized enterprises in 35 European countries whose national business federations are our direct members.

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KEY MESSAGES

1

In recent years, African countries have made great efforts to improve their investment climate, while GDP growth and foreign direct investment (FDI) flows have registered a positive trend. A favourable investment climate is key to attract and retain more private investment, create more and better jobs and improve the lives of their citizens. It goes hand in hand with macroeconomic stability, good governance and the rule of law. Access to markets, the available physical and digital infrastructure as well as a country's policy framework are also key factors. This needs to be accompanied by development financing institutions making more extensive use of innovative financial instruments and blended finance to leverage additional private-sector investment and complement scarce public development funds.

2

Economic Partnership Agreements (EPAs) as drivers of change are important instruments to boost economic relations between Africa and Europe. They remove tariff and non-tariff barriers to regional and international trade and prepare the ground for deeper disciplines that encourage investment in value-adding sectors. Boosting trade and investment and encouraging the creation of regional value chains, EPAs should be used as building blocks to continental free trade in Africa.

3

Education and professional training that provide people with the skills required by the labour market are key factors for development. Cooperation between universities, research institutions and vocational education and training (VET) programmes from both continents needs to be strengthened, including under the EU Erasmus+ programme.

4

A closer dialogue between the public and the private sector in African countries at all levels can be a strong catalyst for reforms, helping to identify problems, find solutions and create an enabling and inclusive business and investment climate. The EU delegations as well as European private-sector organisations should help to foster dialogue.

1. INTRODUCTION

Home to a young population of **1.2 billion people** and some of the world's fastest growing economies, Africa is a vibrant continent that presents tremendous business opportunities. The continent's vast unmet needs and unfulfilled demand make it ripe for entrepreneurship and innovation at scale. According to the African Development Bank, African economies are projected to **grow 4 percent in 2019**, making Africa one of the fastest-growing regions in the world. Moreover, according to the World Bank's Doing Business 2019 Report, sub-Saharan Africa has been the region with the highest number of reforms each year since 2012 and four of the top ten improvers were sub-Saharan African countries in the 2017/18 period. However, high population growth, with millions of young people entering the workforce every year, counteracts economic development, letting GDP per capita grow slower. As the neighbouring continent, Africa's well-being is in Europe's own interest. Therefore, achieving sustainable economic progress in Africa with providing new jobs is high on the agenda of European governments. The continent will need between an incremental **USD 200 billion and USD 1.2 trillion per year** to reach the Sustainable Development Goals by 2030. To fill this investment gap and provide opportunities for a population that is expected to double by 2050 the private sector – both African and European – will need to be involved as a key player in Africa's development efforts. This also requires public financing institutions to evolve from a grant-centred approach to development funding towards a more extensive use of innovative financial instruments and blended finance to leverage additional private-sector investments. Blending allows the mitigation of risk for investors, thereby leveraging higher amounts of investment in African countries. The 28 EU External Investment Plan (EIP) guarantees are a step into the right direction but there must be more instruments available to mitigate the risk of European companies investing in Africa and thereby attract more investment.

Yet, no matter which funding opportunities are available, **businesses can only scale up investment in areas critical to sustainable development if the right policy environment is in place**. Thus, policy-makers in Europe and Africa have recognised the need to improve the business and investment climate for attracting more private investment to Africa. Indeed, the creation of better conditions for business activity and the promotion of private investment play a central role in all recent EU policy initiatives for Africa – the External Investment Plan, the Africa Europe Alliance and the Post-Cotonou Agreement[1]. All three identify public-private dialogue as an important way to achieve this goal.

1 You can find BusinessEurope's suggestions on how the Post-Cotonou Agreement can improve the investment climate and assist European investors in ACP countries here. This document is also annexed to BusinessEurope's broader position paper on the Post-Cotonou Agreement

This paper aims to contribute to the discussion by providing an overview over some of the most important factors that impact the investment climate and determine whether investors consider entering a market. It then outlines some features that public-private dialogue needs to have to be attractive to business representatives and give them the possibility to help identify areas in need of reform to make a country more attractive to domestic and foreign investors. Of course, this paper is non-exhaustive and for a more detailed description of the elements of an attractive investment climate readers can consult the OECD Policy Framework for Investment, in the formulation of which the business community was closely involved.

2. KEY ASPECTS OF A FAVOURABLE INVESTMENT CLIMATE

Interaction with public administrations

In their activities, companies frequently interact with governments. For instance, when starting a business, the number and duration of administrative procedures as well as the necessary amount of minimum capital can constitute an entry barrier. Before starting production, dealing with construction permits, getting electricity and registering property are other important steps where businesses need to interact with public authorities. To avoid that these interactions become bottlenecks to economic activity, it is important that processes are transparent, efficient and the least burdensome possible and that public officials are qualified and accountable.

Policies and regulation

Beyond these direct interactions with public authorities, businesses are affected by government policies and regulations both directly and indirectly.

Once a business is set up and needs to **hire employees**, cumbersome labour laws may result in complex hiring procedures, stringent working hours or high redundancy costs. More importantly, the availability of candidates with the right skills depends to a large extent on the country's **education policies**, including professional training, and the degree to which these take account of labour market needs. Paradoxically, in many African countries there is high unemployment while the private sector lacks employees with the right education and training. Universal access to education as well as demand-driven vocational education and training schemes in cooperation with the European and African private sector must be further promoted. With the rise of digital technologies and services, especially digital skills will be key in the future.

As announced in the Commission's 2017 Communication for a renewed impetus of the Africa-EU Partnership, the cooperation between universities, research institutions and vocational education and training (VET) programmes from both continents needs to be strengthened, including under the EU Erasmus+ programme, which is key to promote the mobility between young people in Africa and Europe. Moreover, private sector-driven initiatives on VET as well as entrepreneurship in Africa should be supported and better coordinated to strengthen the labour market relevance of VET and promote inclusion.

Access to finance is another factor where government activity matters for companies: First and foremost, if a country's credit rating is low, operations in this country are considered risky by financial markets. This also negatively affects the ability of companies operating in this country to get funding. Moreover, many African countries do not have sovereign credit ratings, limiting the access to international credit markets.

On a regulatory level, the degree to which collateral and bankruptcy laws protect the rights of borrowers and lenders can either facilitate or impede lending. Moreover, greater protection of minority investors through clear rules, robust rights and increased transparency helps foster trust and confidence and, in turn, spurs greater access to finance for entrepreneurs. Finally, a well-designed insolvency framework is a vital determinant of debt recovery, making a country's financial system more stable, cutting the cost of credit and improving the recovery rate of viable firms.

International finance institutions have an important role to play in improving the access to finance of companies investing in Africa and should make more use of innovative financial instruments, including syndicated loans, project bonds, partial risk guarantees, aiming to mitigate risk.

Once a company is up and running, the amount of **taxes and mandatory contributions** that a company must pay in a given year as well as the administrative burden of paying taxes and contributions and complying with post-filing procedures matter for its ability to grow. Moreover, a stable and predictable tax regime is important for a company to plan its business activity.

Finally, efficient **contract enforcement** is essential to a good business environment. If commercial disputes arise, the time and cost to resolve them and the quality of judicial processes play an important role. In this regard, a stronger judiciary is associated with more rapid growth of small firms.

Where existing laws are discrepant, businesses can face unnecessary and even contradictory compliance requirements. Where procedures necessary to comply with regulation are complex or unclear, the likelihood of corruption is higher. Where processing times for the required approvals are lengthy, costs for business are driven up. Where corruption and discriminatory law enforcement prevail, it is extremely difficult for new companies to enter the market and stay in it. Where regulatory behaviour of governments is completely unpredictable, businesses are unable to plan their activity.

Macro-level factors

More broadly, macroeconomic stability is a key criterion when businesses explore investment opportunities. It exists when relationships between key macroeconomic variables of a country are in balance – e.g. between domestic demand and output, the balance of payments, fiscal revenues and expenditure, and savings and investment – or if imbalances between them can be financed in a sustainable manner. Features of a macroeconomically stable environment directly relevant to the private sector include a stable inflation rate in the single digits, a stable exchange rate, rising per capita GDP, a sustainable debt-to-GDP ratio or predictable interest rates. Moreover, economies that are macroeconomically stable are less vulnerable to external shocks. All this makes the economic environment more predictable and boosts private investment by increasing business confidence.

In order to ensure macroeconomic stability and create an enabling environment for private investments to thrive, a state must have strong, accountable institutions that ensure good governance and uphold the rule of law. In this regard, it is the state's role to ensure that all public and private actors are held accountable to laws that are publicly promulgated, equally and impartially enforced and independently adjudicated. For this, the institutions of the judiciary must be independent from politics and capable of handling complex commercial cases, enforcing contracts, protecting property rights, and resolving insolvencies should they arrive.

Trade policy and regional integration

On regional level, efforts are necessary to make African countries more attractive to investors by creating conditions under which their economies can diversify and become part of regional and global value chains. Investments in value-adding and labour-intensive sectors require markets to sell the products and services produced. Most African countries on their own are too small to allow for significant economies of scale. Thus, trade policy plays a key role to attract more productive investment to African countries – first, by reducing barriers to regional and international trade and second, by granting the assurances necessary for becoming part of 21st-century value chains. Moreover, trade facilitation is important to enable companies of all sizes to reap the benefits of trade liberalisation fully. The EU should make sure that its trade facilitation activities under multilateral and bilateral agreements and as part of its aid programmes are streamlined to ensure maximum benefits.

Through joining up Africa's fragmented markets, the African continental free-trade area could unlock the tremendous development potential of intra-African trade. The EU should help African countries to reach this goal and can use the Economic Partnership Agreements (EPAs) as building blocks towards continental free trade.

Building on existing regional blocs established by African countries themselves, they promote regional integration on the African continent through **reducing tariff and non-tariff barriers** to regional trade:

- EPA-members need to give the same preferences they grant to the EU also to each other. If implemented properly, they will make their member countries more attractive to both domestic and foreign investors as companies choosing to set up a production plant in a member country can export to the entire region and the EU market without tariffs or quotas;

- At the same time, EPAs lower production costs in Africa by reducing the cost of imported inputs, which are needed to make final products, such as machinery;

- Combined with flexible rules of origin, which give exporters the freedom to source inputs from elsewhere, including from other African countries, without losing preferential access to the EU, this promotes the development of regional value chains and the insertion into global value chains.

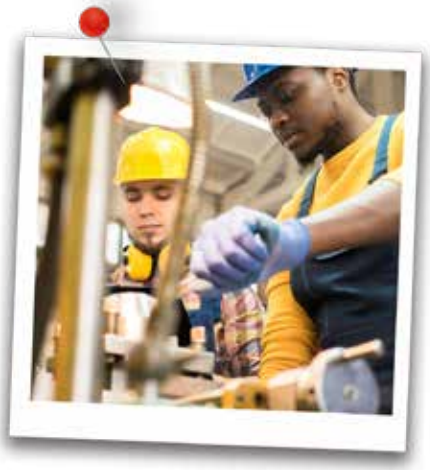
Beyond trade costs, EPAs prepare the ground for some **deeper disciplines necessary for attracting investment** in value-adding sectors. The "rendez-vous clauses" in the African EPAs foresee the extension of the agreements to issues such as trade in services, investment, competition and intellectual property protection, which give assurances to investors and thereby contribute to an investment climate conducive to attracting FDI. This is key for the integration into global value chains for the following reasons:

- Technology transfer is facilitated by assurances that foreign knowledge owners will be treated fairly, and their intellectual property rights will be respected;

- Foreign investments in staff training, physical plants and the development of long-term business relationships are facilitated by assurances on property rights, rights of establishment and fair competition;

- Companies whose value chain extends over several countries need assurances on business-related capital flows (e.g. FDI, profit repatriation) to operate effectively;

- Coordinating international production facilities also requires the continuous two-way flow of goods, people and ideas. Thus, access to world-class services (e.g. freight transport, telecoms, banking, logistics) and assurances on the short-term movement of managers and technicians is important for global value chains.



Infrastructure and connectivity

Gaps in **physical and digital infrastructure, both within and between countries**, negatively affect the competitiveness of companies. High electricity costs and unreliable electricity supply make it difficult for businesses to function well and expand. Poor all-weather road networks and transportation infrastructure (e.g. rail, air travel, seaports, etc.) complicate the transport of inputs and final goods in a country and across borders and make it more expensive. Poor information and communication technology infrastructure impede a firm's participation in international production networks. Large parts of sub-Saharan Africa lack the roads, rails, ports, airports, power grids and IT backbone needed to lift its economies. This **lack of infrastructure hinders the growth of imports, exports, and regional business**. Companies that can connect Africans and markets can prosper. Public-private partnerships have a fundamental role to play in this regard.

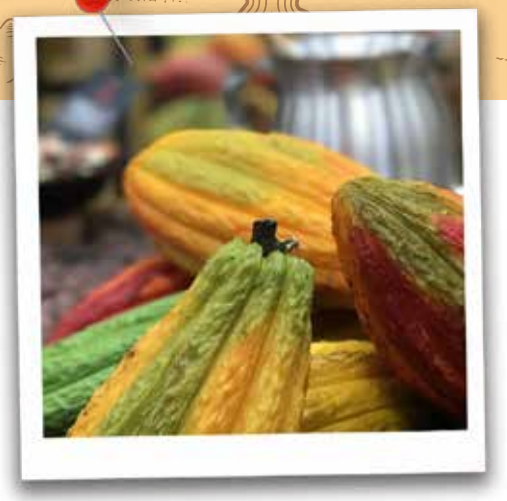
3. PUBLIC-PRIVATE DIALOGUE AS DRIVER OF REFORMS

Role of public-private dialogue

Although the issues mentioned in this paper merely give an overview of some of the most prominent factors that affect the investment climate of a country, the selection illustrates the variety and complexity of relevant factors. Dealing with these issues in their daily operations, **businesses active on the ground are best suited to identify the areas that need to be reformed to improve the investment and business climate** in a country. If they are given a voice, they can be a strong catalysts for reforms, due to their self-interest in good governance and a good business-enabling environment.

Business organisations at sectoral, national and regional level act as mediators between individual companies and policy-makers and thus play a crucial role in aggregating business priorities and concerns and feeding them into the policy process. A close structured dialogue between the African and EU public and private sectors at all levels is therefore crucial to identify problems, find solutions and create an enabling and inclusive business and investment climate.

This **dialogue must be accompanied by increased efforts to build the capacity of these business organisations in African countries** and increase their representativeness. In that respect, European private-sector organisations can play an important role. Through partnerships and focused capacity-building projects, they can contribute to making African business organisations professional voices for the business sector in their respective countries.



In order to be attractive to business representatives, public-private dialogue needs to fulfill certain criteria:

- It should not be a mere box-ticking exercise. Instead of a formalistic approach there should be strategic partnerships with a clear purpose between the public and private sectors;
- The dialogue platforms should be flexible and adjustable to changing circumstances and provide quick results;
- Instead of ad-hoc consultations, public-private dialogue should take place on a regular basis to identify common challenges, inform policy responses, make recommendations and accompany the implementation of policies;
- Business representatives must be able to set the agenda for the discussions and table topics they are interested in discussing;
- The private sector must be involved early enough to ensure that the public-private dialogue has an effective impact.

Role of EU Delegations

The EU has an extensive global network of around 140 delegations at its disposal, which it should use more effectively to support business projects that would benefit several EU countries. One obvious and easy-to-implement improvement to the status quo would be to enable the European External Action Service (EEAS) to show its support for European companies abroad if this is wished for by the company's home country and if there are no objections raised by another Member State. Furthermore, **it is essential that the EU and Member States enhance the coordination of their support to businesses in developing countries** to avoid duplication and unwanted competition.

In addition, EU delegations can help enhance relations and information exchange with the business community in the EU ,as well as with EU businesses present in the country ,and facilitate contacts with local authorities and business organisations. While the **EU delegations in African countries should facilitate policy dialogue between European and local businesses and the respective government**, they should, however, leave the actual dialogue to the relevant private-sector representatives. Moreover, where possible, they should build on existing programmes and structures, including those establised by multilateral devepment banks, to benefit from best practices and maximise impact.

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