"Supporting NEPAD through Increased Capital Flows to Africa"

Remarks by Omar Kabbaj, President of the African Development Bank, at the International Policy Dialogue on "A New Dawn for Africa? - Implementing the NEPAD Agenda"

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Introduction

Mr. Chairman,
Distinguished Participants,
Ladies and Gentlemen,

I would like to begin my short presentation by expressing my appreciation to the Federal Government of Germany and to the Development Policy Forum of Capacity Building International for organizing this important meeting and for inviting me to participate. I would like, in particular, to express our appreciation to Dr. Uschi Eid, the Parliamentary Secretary of the Federal Ministry for Economic Cooperation and Development and the German Chancellor's G8 Representative for Africa, for her untiring support of Africa's development efforts and the African Development Bank. Germany's strong support to NEPAD is well known, and it is therefore fitting that this meeting is taking place in Berlin to discuss how best we can move forward the various initiatives contained in the broader NEPAD framework.

In line with the request of the organizers, I will, in my presentation today, seek to raise for discussion a number of issues related to capital flows to Africa, in the context of the NEPAD Initiative. I will begin by discussing the critical importance of such flows to Africa's development agenda and, in particular, to the efforts that are being made to achieve the millennium development goals (MDGs). After presenting some of the principal characteristics of recent trends and the major factors that have determined capital flows to Africa, I will take up the policy measures that are required to enhance such flows to Africa. I will conclude by highlighting some of the actions that we have
taken at the African Development Bank to mobilize resources for our regional member countries and to encourage foreign investment in Africa.

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Capital Flows and Africa's Efforts to Achieve the Millennium Development Goals

Mr. Chairman,

It is now generally agreed that African countries would need to raise their average rates of economic growth to between 6 and 8 percent - and as importantly sustain them at this level - if substantial progress is to be made towards meeting the MDGs. And while a few countries - such as Mozambique, Senegal and Uganda -- are beginning to register such growth rates, the trend growth for the continent as a whole in the last five years is, however, only around 3.5 percent. It is evident that African countries would need to substantially enhance their efforts to mobilize domestic resources and raise their investment rates, which today average only around 20 percent of GDP. However, it is also clear that for many of the poor countries of Africa much of the required resources will need to come from external sources, given the widespread poverty and the low level of savings that is prevalent in these countries.

In this connection, it is worth referring to the findings of the 2002 Global Poverty Report - a Report prepared by a team from the international financial institutions and led by the African Development Bank. One of the major conclusions of the Report is that for the 30 or so African countries judged to be in a position to use external assistance effectively, an annual increase of official development assistance (ODA) of between $20-25 billion -- from the current level of $13 billion -- would be required.

It is for reasons such as these that NEPAD, in its "Capital Flows Initiative", has emphasized the importance of: (i) raising levels of ODA; (ii) reducing the debt of African countries to sustainable levels; and (iii) increasing foreign private capital flows - both direct and portfolio investment.

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Trends in Capital Flow to Africa

Despite the critical importance of external capital flows to Africa's development efforts, the trends in such flows over the last decade are far from encouraging. The following four major trends are evident from the OECD data on capital flows to Africa:

First, ODA to Africa has declined by 35 percent over the last decade from a high of $24.9 billion in 1992 to $16.2 billion in 2001. In terms of per capita ODA, the decline has been even more remarkable.

Second, Africa has largely been bypassed by the sharp increase in private capital flows to the developing world in the last decade. Capital flows to developing countries increased
seventeen-fold between 1980 and the late 1990s, while capital flows to Africa only doubled during this period.

Third: Foreign direct investment to Africa - averaging less than $10 billion a year during the last five years -- has largely been concentrated in a few countries and in a few sectors. The oil and mining sectors have accounted for the largest share of FDI to Africa, although some countries have begun to attract investment in other sectors, such as cellular telephony, manufacturing, and tourism.

Fourth: While a few capital markets in the continent have attracted portfolio investment from abroad, the overall level is relatively miniscule in relation to the remarkable growth in this type of investment in other countries.

Factors Affecting Capital Flows to Africa

Mr. Chairman,

The unsatisfactory performance of both ODA and private capital flows to Africa is explained by a number of factors. With respect to ODA, the decline is accounted by such factors as: the tight budgetary constraints faced by a number of donor counties in the context of attempts to contain inflationary pressures and remain within agreed macroeconomic targets; the increasing competition for limited donor funds by emerging transition countries - particularly those belonging to the former Soviet Union; and the increasing diversion of limited resources to humanitarian and peace-keeping efforts.

With respect to private capital flows, the limited appeal of African countries to foreign investors is due to two principal factors. First, despite the considerable reforms that many African countries have implemented in the past decade, the actual environment for foreign investment in many African countries is still in need of further improvement. In particular, the poor state of physical infrastructure, the relatively unskilled labor force, the weak regulatory environment, and the inefficiency of government bodies all increase the cost of doing business in Africa, thus deterring foreign capital.

As important, the perception of risk regarding investments in the continent is often heightened by the negative image that is often portrayed of the continent by the international media. Too often, the whole region is associated with civil unrest and political instability. And while some sub-regions and countries have indeed been subject to such upheavals, it is obviously not an accurate image of the entire continent. It is unfortunate that such negative images of the continent persist despite the considerable reforms and improvements registered in a significant number of countries and recognized by such monitoring bodies as the Economic Intelligence Unit, the Wall Street Journal, and the Heritage Foundation.
Policy Measures to Enhance Capital Flows to Africa

Mr. Chairman,
Ladies and Gentlemen,

Achieving NEPAD’s objectives and helping African countries make substantial progress towards achieving the MDGs in Africa obviously requires that action be taken on several fronts. There is in the first instance the need to raise the volume of ODA and also change its modality to enhance its effectiveness. As well, measures are required to improve the general economic and regulatory environment in African countries in order to attract larger volumes of private capital flows. Allow me to outline briefly some of the key measures that are required.

With respect to ODA, there is obviously a need to reverse the trend of the last decade and increase its volume. In this regard, the recent pledge by the donor community at Monterrey to enter into a new partnership with developing countries and to increase annual official development assistance (ODA) by $12 billion by 2006 -- of which half is expected to be allocated to Africa -- is a welcome development. This, however, still falls short of recent estimates such as the one of the 2002 Global Poverty Report of the resource requirements that African countries would need to accelerate their progress towards meeting the Millennium Development Goals (MDGs).

It is therefore our hope that the donor community will indeed continue to increase ODA allocations to meet fully the concessional resource requirements of poor African countries. In addition, there is a need to make ODA more effective by making assistance more predictable to allow for effective medium and long-term planning and by harmonizing procedures and instruments among donors to reduce transaction costs for recipient countries.

Increasing the volume of ODA will also need to be complemented by sustained efforts to reduce external debt and improve market access for African countries. In the area of debt relief, the Heavily Indebted Poor Countries (HIPC) initiative - in which the Bank Group is a major player - has begun to reduce substantially the debt burden of some 22 African countries that have so far qualified. However, given the recent adverse developments in the price of primary commodities, it is essential that the amount of debt relief extended to poor countries is continuously reviewed and adjusted to ensure that debt levels are indeed reduced to sustainable levels.

With respect to improving market access and the removal of trade subsidies that inhibit the exports of African countries, it is our hope that the pledge to work towards the objective of duty-free and quota-free access for all products emanating from the least developed countries will indeed be realized as soon as possible. In this regard, we are heartened by the agreement reached to launch the Doha Development Agenda in the context of WTO negotiations and the recent trade liberalizing initiatives of the European Union and the United States. We are, however, disappointed by recent decisions to maintain or even increase agricultural subsidies in these countries. Nonetheless, the
recent initiatives to improve market access are clearly beginning to demonstrate that such actions can indeed be powerful stimulants for attracting foreign direct investment.

In addition to increasing ODA volumes, reducing debt, and improving market access, donor countries should also consider two other measures to promote private capital flows to African countries. The first is countering the heightened perception of risk by providing more accurate and balanced information on the varied conditions in African countries and by bringing to the attention of investors the many investment opportunities and the high returns that are often available. The second involves actions to enhance existing guarantee schemes - possibly in cooperation with the multilateral financial institutions -- to encourage greater volumes of private investment.

With respect to improving the domestic environment for private capital flows, African countries should consider the following measures:

¨ Deepening the reforms that they have embarked on in the last decade, as maintaining a prudent macroeconomic stance and avoiding policy reversals are critical for preserving the stability and predictability of the investment climate and for building investor confidence.
¨ Continuing to give high priority to improving governance systems. A particular concern of the private sector in this regard is the need to improve the legal, judicial, and regulatory environment.
¨ Improving the efficiency of public institutions to enable them to become effective partners to the private sector.
¨ Deepening financial sector reforms to promote increased mobilization of resources; particular attention should be paid in this regard to the development of domestic/regional capital markets.
¨ Enhancing the efforts aimed at making African economies more competitive - a critical step in this regard is improvement in physical infrastructure that is best achieved through public/private partnerships.
¨ Providing adequate investments to promote human capital formation, as an educated labor force is a key factor in attracting private investment.
¨ Continuing to promote and strengthen regional cooperation and integration efforts to create larger markets that have the potential of being more attractive to foreign capital.

In addition to these measures, a novel scheme that African countries could consider is to have their countries rated by one of the international rating agencies. For example, Senegal sought and obtained a rating from Standard and Poor's that has put the country at par with several medium-income countries. And while Senegal is unlikely to borrow from the international capital market directly, its rating nonetheless is important in giving independent assurances to potential investors.
The Role of the African Development Bank in Promoting Capital Flows to Africa

Mr. Chairman,

Before concluding, permit me to say a few words on the role that the African Development Bank has played in mobilizing resources for its regional member countries, in addition to its role as a catalyst for promoting the flow of private capital to Africa.

Since its establishment, the Bank has approved close to $45 billion to finance projects and programs in its regional member countries, of which $27 billion is from the ADB window, and the balance of $18 billion from the highly concessional African Development Fund and the Nigeria Trust Fund. In addition to financing investment projects in critical sectors such as agriculture, education, health and infrastructure, these resources have also been used to finance important reform measures to improve the competitiveness of African economies. In the last few years, the average level of annual financing operations have been in the order of US$3 billion - the highest level in 10 years.

An important component of the Bank Group's activities in relation to attracting private capital flows to Africa has been its private sector operations. The Bank Group supports the private sector through both its public and private sector windows. Public sector loans and technical assistance grants are provided to help countries reform their governance structures, including regulatory, legal and judicial systems. In addition, the Bank provides support to regional programs and institutions such as the African Management Services Company (AMSCO) and the African Project Development Facility (APDF).

Through its private sector window, the Bank provides financial assistance to entrepreneurs as well as advisory services. A wide array of instruments is used for this purpose, including term loans to private enterprises; equity participation; quasi-equity investments; guarantees; syndication and underwriting. The Bank also extends lines of credit to private financial institutions for on lending to small and medium size enterprises. The Bank's private sector activities have expanded in the recent past and are now well established. In 2002, approvals reached close to $300 million, a 25 percent increase over 2001. Cumulative private sector approvals have now exceeded $1 billion dollars and this is estimated to have helped mobilize a further $5 billion, indicating the important catalytic role the Bank has played.

In the future, the Bank will continue to sharpen and expand its private sector operations. While it will continue to be involved in direct financing of projects in traditional sectors, it will expand its intervention in a number of strategic areas such as private financing of infrastructure and financial services and capital markets. Priority will also be accorded to activities that support privatization, foreign direct investment, entrepreneurship development, capacity building, as well as regulatory and legal reforms. In addition, special attention will continue to be given to the development and strengthening of small and medium enterprises.
Concluding Remarks

Mr. Chairman,
Distinguished Participants,

Permit me to conclude my remarks by emphasizing once again the importance of capital flows to Africa. Indeed, it would be difficult to see the rapid development of the Continent and its integration in the global market without a significant increase in such flows. While African countries will need to continue to create the economic, legal and regulatory environment for attracting private capital flows, it is also essential that the international community support such initiatives by increasing official development assistance, opening the markets of industrialized countries for African exports, and considering new instruments - such as enhanced guarantee schemes -- to promote private capital flows. On its part, the African Development Bank will continue to be a partner to both its regional and non-regional members -- as well as the private sector -- in promoting such flows.
I thank you for your kind attention.