European Investment Bank

AFRICA FINANCE & INVESTMENT FORUM 2009
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INVESTMENT OPPORTUNITIES IN AFRICA, DOING BUSINESS IN & WITH AFRICA

Good morning ladies and gentlemen, it is a pleasure to be here today. Let me add my thanks to EMRC and the sponsors for organising this event.

In my short intervention this morning I have been asked to provide you with an overview of the investment opportunities in Africa and the challenges of, and issues arising from, doing business in Africa.

I shall start with a few words on recent economic developments and the impact of the economic and financial crisis on Africa and then move on to what I believe to be the most pressing challenges that Africa is faced with as an investment destination and to ways in which African policy-makers and the international community can act to address them.

Overview

The global financial crisis has interrupted a period of strong economic performance in Sub-Saharan Africa (SSA): between 2002 and 2007 real GDP growth averaged 6.5 percent per year - a 30 year record - inflation declined to a single digit and fiscal and external positions both noticeably improved. These developments took place against the backdrop of:

- a favourable external environment, with strong demand worldwide, abundant liquidity and booming commodity prices;
- buoyant domestic demand in most of Sub-Saharan Africa, and particularly in some of its most vibrant economies (South Africa, Angola, Ghana, Kenya, Botswana, Mauritius, to name but a few).
- An improved economic policy framework and, thanks to debt relief, a better sovereign debt profile.

While growth has traditionally been episodic in Africa and with significant differences across countries, an encouraging feature of the latest growth spell is that it has involved a large number of countries and it has been more stable and long-lasting.

Figure 1: Real GDP

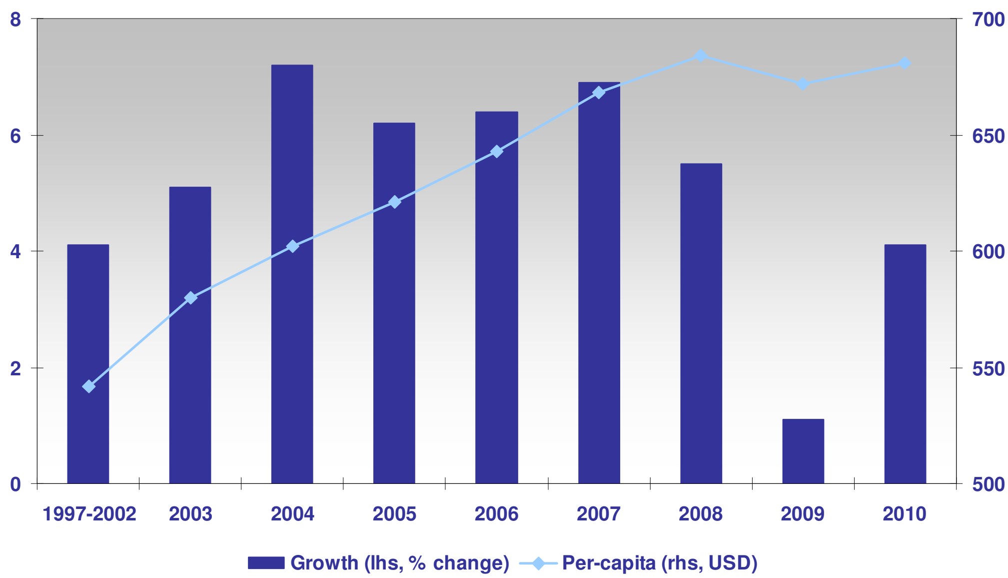


Figure 2: Macroeconomic Balances and Inflation

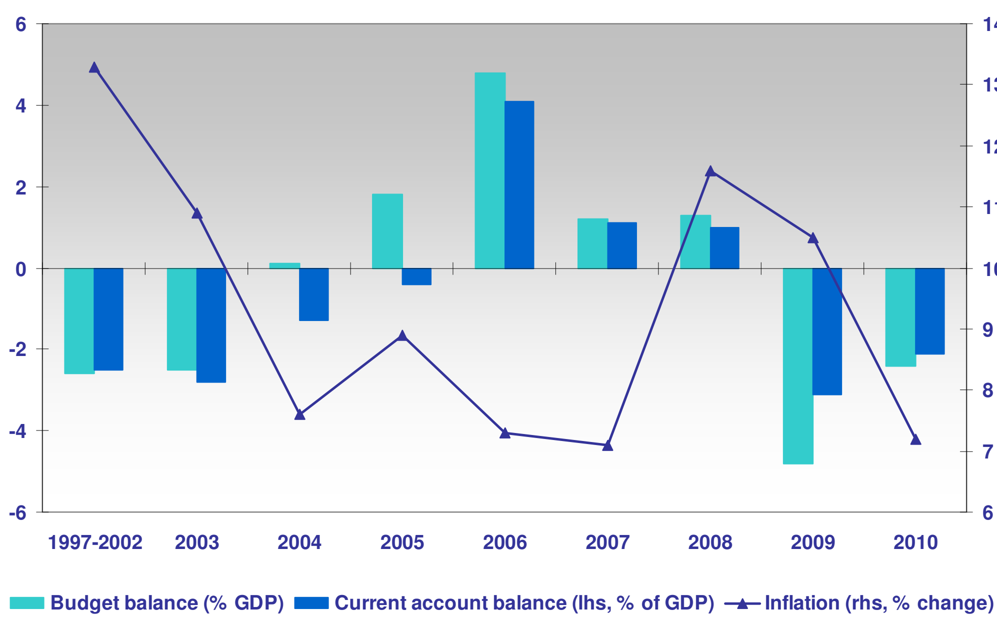
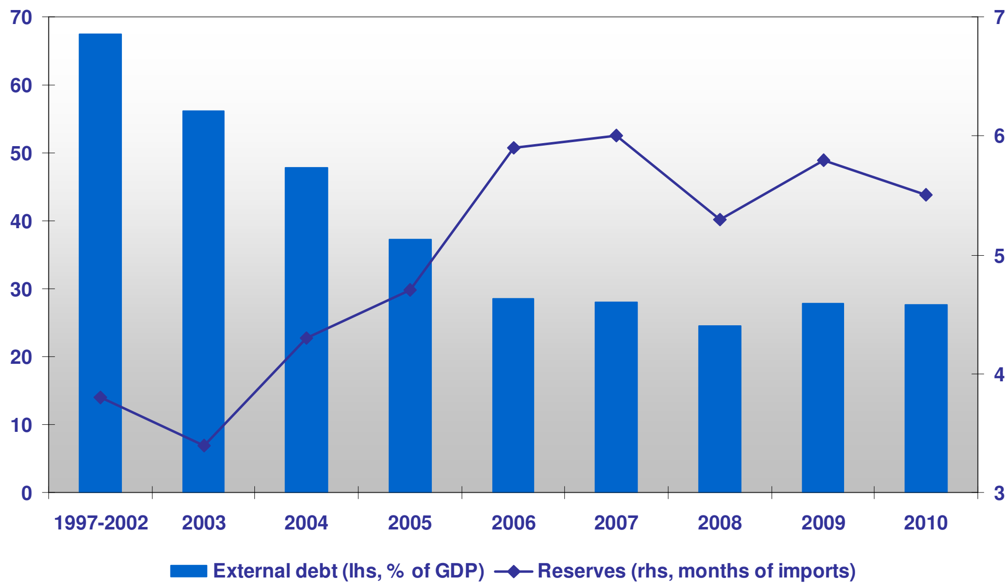


Figure 3: External Debt and FX Reserves



Source: IMF – Sub-Saharan Africa Regional Economic Outlook and WEO On-line Database, October 2009.

However, despite its limited exposure to the epicentre of the financial crisis, Africa has not remained immune to its global economic fallout and spillovers have been quite significant: financial contagion - in the form of depreciating exchange rates and falling stock and bond prices - has hit Africa's emerging and frontier economies (South Africa, Ghana, Nigeria and Kenya), while growth prospects elsewhere have been slashed on account of:

- lower demand for African exports;
- plunging commodity prices;
- lower FDI;
- declining tourism;
- falling remittances.

Hence overall, growth is expected to slow down to a mere 1 percent this year, with per-capita GDP declining for the first time in 10 years.

While the crisis has impacted middle-income countries and commodity-exporters more severely due to their greater integration with and exposure to financial and commodity markets, Africa has suffered a relatively milder blow in comparison to other emerging and developing regions. The slowdown in economic activity has triggered some second round effects in the financial sectors of countries where credit growth had been fast over the past few years, but they have generally escaped the worse of the crisis. All in all, while the toll has undeniably been heavy, especially for the most vulnerable, Africa has so far fared better than in previous crisis episodes. A mild recovery is expected next year, with GDP growth picking up to 4 percent, the third highest growth rate after developing Asia (7.3 percent) and the Middle East (4.2 percent).

Opportunities

Despite the dramatic change in the world economic outlook, there is a general consensus that the global economic crisis is likely to delay rather than derail Africa's return to sustained growth. Based on what we see on the ground, we at the EIB believe that Africa has a considerable potential for investment and growth on account of both the region's natural and human resources and the progress achieved in recent years in improving the policy and institutional environment.

1) Africa is a continent rich in natural resources. These have been an important driver of growth and can contribute to further sustainable and inclusive growth if they are used in an equitable and transparent way. The mining sector provides a particular challenge. Good progress has been achieved in this respect in several African countries, but much more remains to be done;
2) Africa's growing population is feeding a rapid increase of the labour force, a powerful engine of growth if employment opportunities keep pace and workers, especially young ones, have the education and skills to make them effectively employable;
3) Sub-Saharan Africa has a strong core economy, South Africa, and several other vibrant economies (Angola, Nigeria, Kenya, Ghana, Botswana, Mauritius…) that are adding to a dynamic regional scenario; 40% of FDI in SSA comes from South Africa.
4) diversification of the economic and export base has started and is becoming an important source of greater economic stability;
5) economic policies have been increasingly geared towards stability and regulatory reforms have allowed for more open markets and better conditions for private sector investment and development.

Let me cite a few examples: Rwanda is the number one reformer in the world according to the 2010 *Doing Business* – the first SSA economy to achieve such a result since the survey was started in 2004 – and Liberia also appears in the top ten of reformers. Moreover, out of the ten categories used to measure improvements in the ease of doing business, 6 were topped by SSA countries: Rwanda was the country that made most progress in easing employment of workers, access to credit and enhancing investor protection; Mauritius made the greatest stride in facilitating the registration of property; Botswana was number one in improving contract enforcement and Malawi in simplifying procedures to establish a business. Some 2/3 of SSA African countries made at least one investment climate-enhancing reform in 2008/09. While it is true that African countries generally start from very low scores, I find these results quite remarkable;

6) peace and security are returning to Africa, with a marked decline in number of countries involved in conflict, allowing among, other things, for greater local ownership and political participation;

7) finally, there is the belated but growing attention towards regional integration, and the promotion of Africa as an attractive investment destination, which I find particularly encouraging.

These positive developments notwithstanding, it is critical that Africa does not to lose track of these crucial achievements and that it maintains the momentum to address remaining challenges that, while not insurmountable, are certainly significant. Let me now turn to these.

Challenges

Despite the recent successes in terms of accelerating growth, reduced conflict, expanded political liberalisation and improvements in governance, Africa lags behind other developing regions in the world and poverty remains acute and widespread.

According to a flagship study by the World Bank lower levels of investment are crucial in explaining Africa's slower growth and development.[1] Since the 1960s investment as a ratio of GDP in Africa has averaged only about a half that in the rest of the developing world. Moreover, investment in Africa has yielded less than half the return measured in growth terms than in other developing regions.

In other words, Africa needs more investment and, more important, it needs better investment. How can this be achieved? How can the international community help?

[1] Benno Ndulu: *'Challenges of African Growth-Opportunities, Constraints and Strategic Directions'*, The World Bank, 2007.

It seems to me that any investment strategy for Africa (to promote more and more productive investment) will have to involve a set of minimum requirements comprising:

1) continued improvement of the investment climate and of the regulatory framework so as to reduce the cost of doing business in Africa and to alleviate risks, including those related to investor protection and security of property. In this category, I would also include those factors that improve the reputation of a country and its attractiveness as an investment destination, such as enhancing administrative and institutional capacity, strengthening governance and the judicial system and fighting corruption;
2) a wider and more efficient infrastructure network to reduce transactions costs (and particularly the cost of transportation and energy) that make capital accumulation - along with production, and trade expensive and return on investment lower in Africa;
3) supporting innovation and improving the skills and employability of workers, particularly young ones, by investing in higher education and training (quality human capital);
4) developing the financial sector. So far the financial sector has not been particularly supportive of growth in Africa. With a few exceptions in some middle-income African countries, the financial sector remains under-developed, shallow and bank-dominated. Limited and costly access to basic financial services continues to represent a major obstacle to private

sector development, especially with respect to SMEs (this is not a purely African problem – the same issue exists in the EU). Moreover, banks' efficiency remains quite low as illustrated by wide interest rate spreads on the back of high operating costs, conservative lending practices/high risk aversion, lack of competition and high concentration.

While this set of minimum requirements is fairly general, it does not apply to all countries uniformly. There is no standard, one-size-fit-all recipe and priorities should be defined based on individual countries' situation and development needs.

Let me now turn to the Role of IFIs/EIB

Africa's access to the international capital markets and to international bank lending is limited at the best of times and the more so following the crisis. This is where the IFIs and DFIs come in. IFIs can play a crucial role in promoting investment in and with Africa both directly – by supplying finance for key investment programmes - and indirectly, by sustaining macroeconomic stability, by fostering structural reforms, institutional change and capacity building and by providing either implicit or explicit political risk cover.

The European Investment Bank (EIB) – the long-term lending arm of the European Union (EU) – supports the EU's cooperation and development policies in Africa under the Cotonou agreement with the aim of contributing to economic development and poverty reduction. More specifically, the EIB is entrusted (for the period 2008-2013), with the management of:

- the ACP Investment Facility (IF), a EUR 3.2bn risk-bearing revolving fund geared to fostering private sector investment;
- grants for financing interest rate subsidies worth EUR 400m, of which up to EUR 40m can be used to fund project-related technical assistance;

The EIB can also lend up to a further EUR 2bn from its own resources in the ACP countries and up to EUR 900m to South Africa.

The bulk of the Bank's activity in ACP takes place in Africa: 70 percent of the IF portfolio of signed operations in 2003-2008 (over EUR 2bn) is represented by operations in individual African countries and 18 percent by regional operations in Africa and ACP states. Of the Bank's own resources devoted to ACP in 2003-2008 (EUR 1bn), 90 percent are invested in Africa. IF commitments in Africa during 2008 totalled EUR 248.7m (out of 326 3m in all ACP) in addition to EUR 215.8m from the Bank's own resources (out of EUR 225m for all ACP). The figures for 2009 should be higher, reflecting our effort to react to the crisis.

Two key areas of activity of the EIB in developing countries in general, and Africa in particular, are part of what I called the minimum requirements for investment:

- infrastructure projects,
- financial sector operations.

Investment in sustainable and reliable infrastructure is, in fact, a priority for the EIB. In particular, the Bank supports those projects that stimulate economic growth, promote regional integration and hence can make a contribution to the achievement of the MDGs. Given their positive impact on development, governance and social as well as environmental issues, EIB operations in 2008 focused on water and sewerage projects, energy and, to a lesser extent, telecommunications.

In infrastructure the challenge is to make the traditional sectors – energy, water supply and sanitation and transport – financially sustainable and thereby able to attract private capital investment. In this respect a contrast can be drawn with the telecoms sector, particularly mobile telecoms, which is financially viable, and where the private sector is very active, with many public sector utility companies whose financial situation is weak.

The Bank also supported initiatives promoting the emergence of an efficient environment for trade, notably through the EU-Africa

Infrastructure Trust Fund established in 2007 under the EU-Africa Infrastructure Partnership and managed by the Bank.[2]

In its financial sector operations, the EIB's focus is not simply to provide funding but also to promote change through contributing to financial sector development. Thus the Bank aims at filling market gaps by offering products not available from other sources - be it long-term finance in local and/or foreign currencies or risk_capital - acting as a catalyst and emphasising the role of technical assistance and capacity building. The ultimate goal is to facilitate the access to financial services, particularly of micro and small enterprises. To this end, the Bank has also supported an increasing number of microfinance vehicles that invest in, and provide assistance to, local microfinance institutions.

Both because it would be extremely costly for the EIB to lend directly to SMEs and in order to foster the emergence of the financial sector, the Bank pays special attention to the selection of the right intermediaries, based on their financial strength, the quality of their governance, their risk management and internal control systems, as well as their interest and willingness to lend to SMEs. In this context, technical assistance is often provided with a view to

[2] The EU-Africa Infrastructure Trust Fund aims at fostering investment in regional infrastructure in Africa, thus promoting regional integration and trade. The Fund blends grants from EU donors with long-term loan financing from the EIB and other European development finance institutions. In 2008, four grant operations were approved for a total of EUR 47.8m, compared to EUR 15.5m in 2007.

strengthening the capacity of financial intermediaries to deal with small businesses.

In all its operations, the EIB applies the concept of subsidiarity in order to avoid crowding out commercial banks and thereby seeks to bring value added, focussing on private sector-led initiatives that promote economic growth and have a positive impact on the wider community and region. Projects promoted by private sector operators accounted for 48 percent of EIB signatures in SSA in 2008, while 19 percent signatures encompassed a regional dimension. Cooperation and coordination with other IFIs/DFIs and private commercial banks is also centre stage at the EIB: of 26 ACP projects in 2008, 13 were co-financed by international development finance institutions, bilateral and/or multilateral donors.

Concluding thoughts

In conclusion, more and better investment by both the public and the private sector is indispensable for Africa to move on to a higher and long-lasting growth and development path. That is why this forum is important. While the global economic environment has become considerably more difficult, the IFIs have intervened promptly to assist crisis-hit countries and where possible, domestic policy-makers, have used the available room for manoeuvre to support the economy through the crisis. Africa was certainly in a better position to weather the storm than in past crises, due in part to home-grown reform efforts.

So, in short

I. Africa has shown that it can record impressive economic growth rates on a sustained basis.
II. Africa is well placed to emerge quickly from the economic crisis.
III. There is a need to increase the share of investment in GDP and opportunities across the economy exist.
IV. African governments must continue to pursue their reform efforts so as to further increase the attraction of doing business in Africa and investing in infrastructure, and to increase the return on such investment.
V. The IFIs and DFIs are there to support both public and private investment and to attract and crowd in private commercial sector bank finance.

Thank you for your attention.