

Aid and Foreign Investment in a New Agreement

Summary

The ACP countries rely on the EU for 47% of their aid, but budgetary pressures in the EU countries will mean that future flows of aid are unlikely to increase in real terms. It is therefore essential that the ACP countries look for ways to increase the efficiency of the financial and technical assistance they received. In the context of the Lomé Convention; this requires a recognition that Community aid comprises only one-fifth of EU aid and under the Maastricht Agreement, is required to be complementary to that of the member state. The present Convention has too many policy instruments and objectives, and this, combined with accountability to the 15 member states and the European Parliament, and pressures on staffing, has led to weaknesses in the efficiency of aid and pressures to downgrade the importance of partnership and joint responsibility between the Community and the ACP countries. What is needed is a more focused aid programme and given that trade is a wholly Community responsibility, this is the most obvious area for the Community to concentrate its financial and technical assistance. If aid were targeted in this way then the ACP countries would need to evaluate the existing instruments of the Convention. The report therefore argues for a decrease in the number of 'windows' which allocate aid for particular purposes and a greater emphasis on programme aid which, while concentrating on improving supply response in the ACP countries, would be more flexible in tailoring instruments to the specific needs of the ACP countries. We recommend that the present division of responsibilities between DG8, the Centre of Development of Industry and the European Investment Bank be removed in favour of an

integrated programme (comprising a substantial proportion of the financial protocol of a new agreement), administered by a joint ACP-EU Productivity Centre, and involving participation by the public and private sectors. It would be responsible for the development of the physical infrastructure, legal, financial, education and training, technology diffusion, marketing and institutional capacity which is necessary to increase the integration of the ACP countries into the world economy. It would also advise on measures to increase the flow of foreign direct investment into the ACP countries and measures which sought to increase regional integration. Foreign direct investment flows to the ACP countries have been disappointing in terms of both volume and in increasing the competitiveness of the ACP countries non-oil and minerals sectors, although there are significant variations in experience between ACP countries, especially in recent years. Proposals are put forward to improve the content of Title III Chapter 3 (on Investment) in the Convention, especially aimed at reducing the riskiness of investing in ACP countries, and additional measures are highlighted which could increase the attractiveness and ease of investing and which could benefit from the support of the EU in a new agreement.

6.1 Prospects for Future Aid Flows to the ACP Countries

EU bilateral and institutional aid to the ACP countries increased as a proportion of total OECD aid to these countries from an average of 40% in 1983-87 to an average of over 47% in 1988-93, representing an increase in an already substantial level of dependence on the EU for

aid. At the same time, total flows of aid, measured at constant prices and exchange rates (1993), by the OECD countries to Sub-Saharan Africa are approximately 10% less than they were in 1980 and have stagnated in real terms in the 1990s. A further disturbing factor is that while there has been a rising trend in the share of EU institutional aid to the ACP countries from an average of 18% of total EU aid for the period 1983-87 to an average of 21% for 1988-93 (and over 22% 1991-93), there was considerable difficulty in reaching agreement among the EU governments over the size of the EDF 8 covering the ACP countries for the period 1995-99. The final agreed increase was over 10% less than the amount required to maintain the real value of EDF 7, despite the accession to the EU of three new member states (Austria, Finland and Sweden).

Coinciding with these trends has been the large increase in aid to the Central and East European Countries (CEEC), Russia and the Newly Independent States (NIS). OECD aid to these countries increased from \$2.25 billion in 1990 to \$7.1 billion in 1991 and since then has more or less stabilised at this level. The EU has accounted for over 60% of this aid and this raises the question of whether aid to E. Europe has 'crowded out' EU aid to the ACP countries. In one sense this question is unanswerable since we cannot know precisely what EU aid to the ACP countries would have been in the absence of the transformation of the CEEC/NIS countries. We can, however, indicate whether increased aid to E. Europe has coincided with decreased aid to the largest member of the ACP group, namely Sub-Saharan Africa (SSA). OECD aid to the SSA decreased by 0.5% p.a. in real terms in the period 1991-94 while EU aid decreased by 3.5% p.a. Caution, however, is necessary in interpreting these flows. Aid disbursements vary from year to year and this period of time is too short to draw strong conclusions on trends. Also, when EU flows are examined in more detail we can see that EU aid declined largely as a result of a sharp decline in aid from Italy to SSA and this was

paralleled by a decline in Italian aid to the CEEC/NIS countries. Aid from France and the UK to SSA was more or less constant in real terms and interestingly aid from Germany to SSA increased in real terms, despite the fact that Germany has accounted for over half of EU aid to Eastern Europe. The tentative conclusion we would draw is that there is no evidence, as yet, of 'crowding out', but that equally it is too early to reach firm conclusions.

A more important factor affecting future aid flows than aid diversion to E. Europe is the general budgetary pressures which will increasingly affect EU budgets and make it very difficult significantly to increase aid flows in real terms from their present levels.

Aid budgets have come under pressure in the EU countries, partly as a result of the need to contain rising government expenditure and partly to stabilise and if possible reduce burdens of taxation in order to improve the competitiveness of their economies. Government expenditure has increased mostly as a result of the substantial increases in unemployment in the EU countries, generating higher social security payments whilst at the same time reducing the tax base of the economy. Initial optimism that this was largely a cyclical phenomenon has been replaced by a general view that the causes are, to a significant extent, structural and that Europe's 'natural' long term level of unemployment may have increased. Pressure on budgets has also increased as a result of the need for large scale reconstruction in the former East Germany, structural adjustment required in member states such as Greece, Spain and Portugal to enable them to compete in the EU, and financial assistance required in particular sectors of the EU such as agriculture and fisheries, coal, iron and steel. At the same time, the objective of trying to meet the maximum government borrowing requirements required by single currency provisions (a maximum budget deficit of 3% of GNP and a maximum level of public debt of 60% of GNP) of the Maastricht Treaty have forced governments to introduce policies aimed at cutting expenditure and increasing

revenues, thus further depressing their economies and raising unemployment. These are all difficulties and pressures which will not easily be reduced and can be expected to continue well into the next century.

These budgetary pressure can be expected to intensify with the future integration of the six CEE countries (Bulgaria, the Czech Republic, Hungary, Poland, Romania and the Slovak Republic) and the Baltic States (Estonia, Latvia, and Lithuania) into the EU. Integration will be phased over a period of time with some countries joining the EU substantially ahead of others, but the demands on the EU structural funds will be substantial. In addition, these countries have large agricultural sectors and even with a significantly reformed CAP (itself a very sensitive political issue), the pressure on the financial resources of the EU both from existing and from new member states, will be considerable.

The implication of these budgetary pressures is that EDF aid needs to be used as efficiently and productively as possible and this requires greater focus and targeting in a new agreement.

6.2 Weaknesses in EU Institutional Aid

Too many instruments and objectives

The Lomé Convention provides for 12 areas of co-operation:

- Title I: Environment
- Title II: Agricultural co-operation, food security and rural development
- Title III: Development of fisheries
- Title IV: Co-operation on commodities
- Title V: Industrial development, manufacturing and processing
- Title VI: Mining development
- Title VII: Energy development
- Title VIII: Enterprise development
- Title IX: Development of services

Title X: Trade development

Title XI: Cultural and social co-operation

Title XII: Regional co-operation

Successive conventions have increased the range of themes which cut across these twelve areas of co-operation. For example:

- food security;
- support for structural adjustment;
- integration of women into development;
- poverty, health and education;
- support for an increased role for the private sector ; and
- protection of the environment.

The 1991 Maastricht Treaty on European union established the objectives of EU development policy as:

- sustainable economic and social development, especially for the poorest;
- integration of developing countries into the world economy;
- the alleviation of poverty; and
- observance of human rights, consolidation of democracy and the rule of law.

The negotiation of successive Conventions has also increased the range of instruments and financial schemes. For example, in the Lomé IV financial protocol 1995-2000, of a total of ecu 14,625 million, ecu 12,967 million was allocated to the European Development Fund (EDF) and ecu 1,658 million to the European Investment Bank (EIB). Ecu 1,000 million of EDF resources were allocated to risk capital and of the remaining resources a further 48% were allocated as grant aid for the following:

- stabex ecu 1,800 m;
- structural adjustment ecu 1,400 m;

regional co-operation ecu 1,300 m;

of which:

regional trade promotion ecu 85 m;

institutional support ecu 80 million;

Centre for Development of Industry
ecu 73 million;

joint Assembly ecu 4 m;

sysmin ecu 575 million;

interest rate subsidies ecu 370 million;

emergency refugee assistance
ecu 260 million;

of which:

emergency aid ecu 140 m;

refugees ecu 120 m;

As a result, only 43% of EU institutional aid is freely available to finance programmes in the ACP countries. The prior allocation of aid for specific purposes means that unless the EU has perfect foresight, then there is either too much or too little aid for the designated purpose. Either way, it implies an inefficient use of aid.

This proliferation of objectives and policy instruments has not been the result of the evolution of a consistent development strategy for the ACP countries, but rather piecemeal, ad hoc, additions derived from changing fashions in development (primarily emanating from the EU countries) and the belief that the more 'windows' for aid there are the greater the volume of aid received by the ACP countries.

The changing fashions in aid (often vigorously advocated by influential NGOs) may have some merit in themselves, but they need to be carefully evaluated in the light of the main policy objectives of the ACP countries. Unfortunately, these policy objectives are often defined in the most general terms, both in the Convention and by most ACP countries, and are never prioritised.

This results in a confusion of means with ends, so that the overall efficiency of the aid programmes are reduced and conflicts between objectives emerge (although within the limitations of the Convention as a whole, the management of projects has probably been improved by the introduction of the 'logical framework approach' to project cycle management in 1992). It has also meant that the Convention comprises an incomprehensible mass of schemes and instruments of which few people have an overall understanding, and as a result many of the provisions of the Convention are either neglected or utilised in National Indicated Programmes (NIPs) in an arbitrary and unsystematic manner. At the same time, the focus on instruments *referred to* in the Convention may well lead to a neglect of more appropriate instruments *not contained* in the Convention, but which may be of potential value to an individual ACP country or groups of ACP countries. This danger may be compounded by an excessive attention to control and accountability by the Commission which stifles innovation (ECPDM, 1996) and adaptability essential to the effectiveness of aid in individual ACP states.

The idea that the more 'windows' there are for aid the more aid you obtain, has always been of doubtful validity. The reality is that the aid budget of individual donors are always the result of annual bargaining between ministries for limited resources and is conducted in terms of overall amounts, with only a limited reference to broad aid commitments and with no reference to the minutiae of individual policy instruments or 'windows'. This is all the more true in the present situation of severe pressures on the budgets of the EU member states and increasing aid commitments to non-ACP countries, particularly in Eastern Europe. The objective of the ACP should therefore be to concentrate on ways of *increasing the effectiveness* of Community aid.

Weaknesses in the main agreement of aid and aid conditionality

A recent report (Koning 1995) provides a useful analysis of the strengths and weaknesses in the

management of the EDF (an analysis which is, incidentally, largely absent from the Green Paper). The report concludes that while there is no obvious shortage of staff relative to other comparable donor agencies, specialist staff are concentrated in 'traditional areas and this creates a gap in priority fields. Although these gaps are generally filled by consultants, adequate supervision is required. The ratio of support staff to other staff is low, causing overburdening of professional staff with administrative functions both in Brussels and in the delegations' (Koning, 1995).

A particular feature of the EDF are the delegations located in ACP countries, but a recent study noted a lack of decision making authority in the delegations which led to delays and inefficiencies (Price Waterhouse 1992).

Similar conclusions were reached in a detailed study of EU aid to Ethiopia (Maxwell, 1996) which, *inter alia*, concluded that 'the capacity of the EU to implement an aid programme falls some way below its capacity to agree on overarching aid framework and establish aid instruments' and that there was 'an overriding impression of an aid programme that was bigger than the capacity to manage it'.

The Green Paper sees a significant cost of the partnership principle of Lomé in terms of a reduced efficiency of aid and 'in its eagerness to improve the efficiency of aid operations, the Community has tended to take the place of its weaker partner, adopting a more interventionist role that is hard to reconcile with the recognised need to encourage the recipient countries to take charge of their own development process' (p. 7). The downgrading of the principle of partnership and joint responsibility for the aid programmes has been most clearly seen in the use of conditionality in the disbursement of funds under the various instruments of the Convention, notably in the case of Stabex, and the use of these instruments to obtain leverage on ACP policies.

Now it is axiomatic that the efficiency of an aid programme depends on the social, political, and economic environment in which it takes place and the EU has a legitimate interest in

ensuring that the basic requirements for the success of aid financed projects are met. Earmarking funds for particular purposes, however, is a very inefficient way of achieving this object. Conditionality, properly conceived and adapted to the individual needs of a country (a particular objective of EU structural adjustment assistance), can be helpful in producing 'performance contracts' whereby aid flows are guaranteed provided certain agreed results are achieved, but it needs to apply to the whole programme of aid (not simply EU aid) to an ACP country and, furthermore, needs to be closely co-ordinated with other aid donors, otherwise conflicting and self-defeating requirements will be made of recipients. Focusing aid and simplifying the range of policy objectives and policy instruments will require the ACP to accept EU involvement in conditionality and to engage in a more general policy dialogue than occurs at present with the EU. ACP countries will also have to increase their institutional capacity to engage in such a policy dialogue. The benefits, in terms of a more flexible and efficient aid programme, better targeted to their needs, are however, very substantial.

6.3 Basic Principles for Restructuring the Convention

There is an overwhelming need to restructure the Convention so as to make it more workable and realistic by simplifying its content and concentrating on achievable objectives, both in terms of EU resources and in terms of the needs and development capacities of the ACP countries. How could this best be achieved?

The starting point is whether a new Convention is to be seen as a 'blueprint' for ACP-EU development corporation (i.e. the 15 member states plus the Commission), fulfilling the Maastricht objective of greater co-ordination between the members states in their development co-operation policies (at present limited to guidelines for common policies in poverty alleviation, health and education, and

food security), or whether it will be confined, as at present, to European Commission-ACP relations (with some degree of co-ordination with the actions of member states). The former is an attractive objective since it could lead to much better co-ordination and increase the effectiveness of the EU overall, and is implicit in the Commission's Green Paper which considers the objectives of EU aid and not just Community institutional aid. Aid, however, is very much viewed, at least by the larger EU donors, as serving their foreign and commercial policy objectives and the most that can therefore be expected is better co-ordination between the member states and the Commission, with the Commission acting as a clearing house, channelling information to the member states on each other's initiatives in the ACP countries.

One of the distinctive features of Lomé aid is the ideal of partnership and policy dialogue between the EU and the ACP. Community aid, also has the advantage of not being driven by the foreign policy and commercial interests of an individual member state and so is therefore potentially more development oriented than bilateral aid. At the same time, the Commission does not have the human and financial resources of big international institutions like the World Bank and UNDP, and only accounts for 18% of EU aid to the ACP states. The combination of these considerations with the need to simplify the Convention and concentrate on essential development objectives suggests that a *new Convention should be based on the areas in which the Commission has a particular contribution to make, as compared to other multilateral, institutions and bilateral donors.*

In view of the fact that trade is exclusively an EU responsibility, then this would be one of the most obvious areas for the Commission to concentrate on (though not necessarily the only area). This would also fulfil the Maastricht Treaty objective of integrating the developing countries into the world economy and is of vital importance not simply to the more developed ACP countries, but also to the least developed countries. Other objectives, such as the alleviation

of poverty and protection of the environment, would form an integral part of such a programme, while the means of achieving the objective of improving the trade performance of the ACP countries would encompass both direct measures to improve production, marketing and distribution, and indirect measures concerned with education and training, support for the private sector, institution building in the public and private sectors, and regional integration.

The ACP countries may also wish to consider other objectives of EU assistance such as food security. The important point is that these objectives should be kept to a minimum and EU assistance *focused* on these few objectives.

Similarly, the range of policy instruments needs to be simplified and focused (Maxwell 1996) and this requires the ACP countries to evaluate the effectiveness of existing instruments. For example, does Stabex (the largest single instrument of ACP-EU financial co-operation and allocated Ecu 1800 million between 1995-2000) serve the trade interests even of the relatively few ACP countries which significantly benefit from it? (Lingnau 1996, quotes a study by Ohlin 1993), that 'only a handful of countries have received three-quarters or more of the transfers, leaving over 60 countries to share the rest'). Some observers note, for example, that by providing aid based on exports of a specific list of commodities it may act as a disincentive to export diversification, while at the same time ensuring supplies of these commodities to EU multinationals. At the same time, it should be recognised that Stabex has a high degree of acceptability among ACP countries, presumably because it provides aid automatically to qualifying states. Despite its title, however, Stabex does not stabilise the export earnings of the ACP countries, but only the earnings from a list of 50 products, mainly exported to the EU. The scheme was devised in the 1970s, when it was expected that world commodity prices would be stabilised through international agreements and buffer stocks. This did not occur and so the funds available for Stabex have been inadequate to

stabilise commodity earnings against large fluctuations in world prices. Partly to deal with this situation, the formula for deciding whether payments should be made, arbitrarily excludes the highest and lowest level of earnings when calculating the average (reference) level of export earnings over a six year period. As a result, a rising trend (with the usual variability around the trend) of export earnings over the six year period, with a drop in earnings in the seventh year, will result in a much smaller Stabex payment than could be rationally expected on the basis of the differences between the expected value (based on the exponential trend value) and the actual value of export earnings. Thus, not only is the fund based on an arbitrary list of products (so that countries with balance of payments problems can receive payments while those with problems cannot claim), with inadequate funding to guarantee payment, but it also does not address the fundamental reasons why export instability creates harmful effects on the growth of the economy (the basic objective of Stabex as stated in Article 186). The funds allocated to Stabex could be used for other purposes and the ACP countries need to evaluate this opportunity cost of the scheme. If it is decided to retain the scheme then the objectives of the scheme need to be more clearly and realistically specified in the context of the funds available, and the rules and procedures of the scheme revised so that the scheme can meet these objects. For example, it may be decided that, given the limited financing of the scheme, it would be more appropriate to consider it part of a disaster relief operation than a stabilisation fund, in which case rules would be devised governing eligibility on that basis.

The same considerations apply to other funds earmarked for a specific purposes. More generally, the ACP countries need to consider whether it would not be more in their interests for the EDF to go back to its original form and greatly increase the proportion of programmable aid (not pre-allocated for specific purposes) from its present level of 43% of total financial resources.

A further strategic area for the ACP countries to consider follows from this discussion, namely, that if total EU aid becomes more programmed to the individual needs of ACP countries in exchange for agreement on a few key areas of ex-post conditionality, then the present system of five-year allocations of aid to individual ACP countries may lead to even lower levels of disbursement than at present. If a number of ACP countries consistently fail to meet the conditions of the grants (EDF 8 specifies that 70% of the overall financial envelope can be released and that the remaining resources may be allocated, depending on the progress achieved in the execution of the first tranche and the state of preparation of activities envisaged with the second tranche). At present, unspent sums allocated to an ACP country under one EDF are simply transferred to the country's allocations for the next EDF, but if these accumulate to a significant degree then there is a substantial opportunity cost to other ACP countries which could productively use these resources. The ACP may therefore wish to consider introducing a mechanism by which an unused proportion of aid above a certain threshold is made available to other ACP countries (analogous to the redistribution of quotas under the sugar and beef protocols).

6.4 Aid and the Integration of the ACP States into the World Economy

This report has emphasised in Chapter 1 the impact of the forces of globalisation and liberalisation which pose both a threat and an opportunity for the ACP countries. In order to take advantage of these opportunities, the ACP will essentially have to pursue a 'niche filling' strategy and the experience of rapidly growing economies indicates that a network of micro, small and medium-sized enterprises are fundamental to such a strategy because they offer the advantages of flexibility and adaptability to constantly changing market conditions. The analysis of the export record of the ACP states in Chapter

2 showed that, contrary to the general view, an increasing number of ACP countries had diversified their exports, but that this process needs to encompass a larger number of countries and has not extended to a sufficient group of products, or covered a sufficiently wide range of rapidly growing markets. The experience of ACP countries which had implemented structural adjustment policies has shown that these have improved export performance, but case studies indicate that although these policies are necessary for improved performance, they are not sufficient. They need to be complemented by detailed supply side policies which improve both the general economic environment of the country and provide a specific and targeted network of support for micro, small and medium-sized enterprises. In this way, the ACP states could achieve the objectives of 'growth with equity'. The policies and instruments necessary to achieve this have been analysed in detail in Chapter 4 and 5.

We have argued for a much more focused and targeted approach to the use of Community aid resources, and that supporting ACP export capacity building should be one of the main objectives of a new agreement. In order to give effect to this proposal, the financial and technical assistance of a new agreement needs to be closely co-ordinated and integrated within a joint ACP-EU organisation which replaces the existing division of responsibilities between the Commission, the European Investment Bank and the Centre for Development of Industry. To be effective it also needs to involve the active participation of both the public and the private sectors in the ACP and EU. This joint organisation, which could be called the ACP-EU Productivity Centre, would be wholly responsible for developing the export capacity of the ACP countries and would have at its disposal a substantial proportion of the financial protocol of a new agreement. It would bring together under one roof the resources necessary to development: physical infrastructure, legal, financial, education and training, technology diffusion, marketing and institutional development

(including building, for example, on the antennae systems of the CDI, linking local enterprises with fundholders and policymakers). It would advise on the structure of incentives in ACP countries, on the regulation and promotion of foreign investment, and on regional policies which could enhance export performance. It would also closely liaise and co-ordinate its efforts with other bilateral and multilateral aid donors, but its underlying philosophy would be to recognise the importance and significance of market failure and missing markets in ACP countries, and the need for intervention and institution building.

The instruments for meeting this overall objective would vary according to the needs and the level of economic development of individual ACP countries. Some of the more advanced ACP states may be considered largely able to finance their development through their own resources, foreign investment and borrowing, and indeed may be legitimately constrained in their access to aid finance in a new agreement. In these cases, the requirement would be largely for a substantial amount of technical assistance to organise and implement a strategy for improving export competitiveness. The majority of the ACP countries, however, will require a mix of financial and technical assistance with financial assistance including direct support for establishing and building up productive activities, supporting services, networks and institution building (including the establishment of National Productivity Centres in the ACP states). In all cases, counterpart finance would be required from the public sector and beneficiaries in the private sector in the ACP countries, and targets would be set both for performance and for the progressive transfer of ownership and responsibility for the enterprise to the ACP country. This co-ordinated package of support would be targeted at particular sectors of the economy, and, where appropriate, we would suggest the use of a suitably modified form of the Centre-Satellite system discussed in Chapter 5.

Additional financial and technical assistance

will be required if an ACP state decides to negotiate and implement a free trade agreement with the EU (as discussed in Chapter 3).

We have also discussed in Chapter 1 the need for EU assistance in enabling the ACP countries both to participate more effectively in the WTO, and in implementing and explaining the implications of the Final Act of the Uruguay Round and the Marrakesh Agreement to the private sector in the ACP countries.

It has also been suggested in this report that the EU could act as a channel of information and export promotion between the various geographical grouping of its special preferential trade agreements, and in particular between the ACP group and the CEEC/NIS countries. This could be organised through the ACP-EU Productivity Centre in collaboration with the appropriate organisations contained in the Europe Agreements.

We recognise that these proposals represent a major departure from traditional relations between developed and developing countries, but just as Lomé I represented a new departure and innovative thinking on North-South relations in 1975, so a new agreement needs to concentrate on one of the main issues of our time, namely to increase substantially the degree of integration of the ACP countries into the world economy.

6.5 Flows of Foreign Direct Investment to the ACP Countries

'Private investment in developing countries has shown a marked revival as a consequence of the widespread progress in stabilising macroeconomic balance in individual countries' (International Finance Corporation, 1995). In contrast, most African countries 'have improved, typically within structural adjustment programmes, their regulatory frameworks and they try to increase investor confidence through the conclusion of bilateral investment and tax agreement and are subscribing to multilateral agreements pertaining to FDI ... (however) for the continent as a whole,

FDI flows have not responded or, at best, responded unevenly' (UNCTAD, 1995). A similar conclusion is reached by the IFC in terms of trends in private investment in development countries 1970-74, 'an improvement in economic growth rates in Sub-Saharan Africa in 1994 was generally not accompanied by higher private investment. The overall trend of low and falling private investment rates continued'. (IFC, 1995, p.4). In Asia and Latin America, foreign direct investment is the largest component of net resource flows, whereas in Africa it comprises only 12% of these flows (UNCTAD, 1995).

A recent and more detailed study (Bennell, 1994) of UK manufacturing investment in 14 Sub-Saharan African countries (accounting for 50%-80% of all manufacturing FDI in these countries) paints an even gloomier picture of a trend of dis-investment in the 1980s *accelerating* in the period 1989-94. This dis-investment was greatest in intermediate and capital goods, with the result that manufacturing investment has become increasingly concentrated 'in the production of relatively low value added wage goods, bulky intermediate goods, and a very limited range of metal and electrical goods. Most of these activities use relatively simple and increasingly out-dated technologies' (p.7). The study records that in 1989, 90 UK companies had 336 equity involvements, in manufacturing. By mid-1994 this had fallen to 65 companies with 233 equity involvement in manufacturing and by the end of the decade this could be expected to have fallen to around 30 or 40 companies. The reasons for this were partly due to a world-wide phenomenon of MNEs concentrating on core activities, but interviews also showed that MNEs had become 'weary of dealing with all the problems of manufacturing in Africa' (p.12). MNEs were also highly critical of the structural adjustment policies in Africa which they considered were too simplistic and had been too rapidly implemented with the result that 'there may be "nothing left" (of manufacturing) in the medium to long term' (p.11). Also, while local currency rates of return on investments were substantial, £ sterling

rates of return were inadequate, reflecting the large devaluations of most countries over the period. Fears over foreign exchange problems are now widespread and the author concludes that unless these 'can be satisfactorily resolved, then the prospects for significant increases in manufacturing FDI, even among existing investors, remain bleak' (p.15).

As we have emphasised, however, it is very difficult to make valid generalisations about such a heterogeneous group as the ACP countries and a recent World Bank study (Bhattacharya, Montiel, Sharma, 1997) points out that while FDI flows have been stagnant or shown only a small increase for the CFA countries, and countries with negative per capita growth, other Sub-Saharan African countries have recorded significant inflows. These countries fall into three groups. Firstly, long term recipients such as Botswana, Mauritius, Seychelles, Swaziland and Zambia, where flows have remained constant or declined. Secondly, countries recording large increases, mainly in the oil and mining sectors, such as Angola, Cameroon, Gabon, Ghana, Guinea, Lesotho, Madagascar, Mozambique,

Namibia, Nigeria and Zimbabwe. Thirdly, countries where FDI was low and declining in the 1980s and early 1990s but where flows have now reversed, sometime to a spectacular degree, such as in Uganda.

In the case of the Caribbean and Pacific countries, some countries have experienced substantial net inflows over the period 1990-94, especially when standardised on a per capita basis or relative to GDP, and compared to major beneficiaries of FDI such as Chile, Mexico and Thailand (see Table 6.1).

Substantial net inflows, relative to the size of the economy have also been recorded for Antigua and Barbuda, Barbados and The Bahamas, though these countries may, to a certain extent, be regarded as special cases.

6.6 Measures to Increase the Flow of FDI

Most ACP countries, however, have received only modest inflows and this is disturbing in the light of the potential benefits of FDI in terms of technology transfer and access to markets, knowledge and information not easily available, or

Table 6.1 Net Inflows of FDI 1990-94

	Average 1990-94 \$m	\$ per capita	\$ per \$1,000 of GDP
Dominican Rep	166	21.3	16.0
Jamaica	121.6	48.6	29.0
Trinidad and Tobago	270.4	216.3	56.3
Fiji	46.6	60.5	20.3
Nigeria	1100	10.2	33.8
Swaziland	34.9	42.0	38.8
Chile	511.6	36.5	9.8
Mexico	5409.0	60.8	14.3
Thailand	1554.0	26.8	10.8

Computed from: International Financial Statistics 1996, World Development Report 1996.

- Note 1 Papua New Guinea not included in the table because substantial net inflows in 1990-92 became small net outflows in 1993 and 1994.
2 Mauritius not included because net inflows of up to \$40m in 1990 became net outflows in 1991-93.

unavailable, from other sources. Moreover, a large proportion of FDI has been in resource based industries with little domestic processing and refining, or in tourist enclaves, so that the contribution to the ACP countries has been largely confined to the generation of government revenues, and in the case of tourism a (varying) degree of local employment. There is therefore a need for increasing substantially both the quantity and the quality (in terms of contribution to the development of the host economy) of MNE involvement in the ACP countries, for example, in manufacturing, infrastructure and tourism related goods and services.

International agreements

As we have mentioned, most ACP countries have reformed their authorisation and regulatory procedures for FDI and many are now signatories to the four major multilateral investment conventions⁶ and have concluded bilateral investment treaties with capital exporting countries. In addition, as discussed in Chapter 1, the ACP members of the WTO have also to conform to the agreements on Trade Related Investment Measures (TRIMS) and Trade Related Intellectual Property Rights (TRIPs). There would therefore appear to be little more that these ACP countries could do to further investor confidence through international agreements.

The Lomé Convention

With regard to the Lomé Convention, Title III, Chapter 3 on Investment provides for investment promotion, investment protection and investment finance, but the resources devoted to these tasks would appear to be quite inadequate, while the usefulness of the European Investment Bank as a vehicle for providing investment finance may be questioned, given its lack of knowledge and local representation (in comparison to other agencies such as the

Commonwealth Development Corporation).

Foreign investors tend to view SSA as a whole and so the problems of some states leads to a general perception that the whole sub-continent is risky and unstable. Much greater effort could be made by the EU to use Ch.3.1 and 3.2 of the Convention (investment promotion and protection) to educate potential investors to the contrary and to back this with investment guarantee schemes for stable countries. Similarly, potentially profitable investment opportunities for involvement by EU multinational companies in the Caribbean and Pacific would also benefit from much greater support from these instruments of the Convention for the dissemination of information and support for SMEs in obtaining equity and loan finance.

Article 271 states that 'in assisting the ACP to invest in PMDT, particular attention shall be paid to supporting optimal use of existing capacity of the ACP states concerned and the need for rehabilitation'. Given the very low levels of processing of natural resources in the ACP countries, and the potential benefits from this, the provisions of this Article are inadequate. PMDT could be targeted as a priority area for action and more resources devoted to identifying the reasons *why* MNEs do not engage in higher levels of processing in the ACP countries, and formulating investment proposals to overcome problems, where such processing could be economically carried out.

Most ACP countries are seriously deficient in a whole range of infrastructures, including not only physical infrastructures, but also financial services, and lack both the capital and personnel to bring these up to a standard essential for the development of an efficient and viable economy. Privatisation programmes in Europe have created large enterprises which are already involved in rehabilitating the

6 Multilateral Investment Guarantee Agency (MIGA); Convention on the Settlement of Investment Disputes between States and Nationals of other States; Convention on Recognition and Enforcement of Foreign Arbitration Awards; Convention for the Protection of Industrial Property.

infrastructure of the Eastern European countries, and a new Convention could include specific mechanisms to encourage similar private sector investments and involvements in the ACP countries and especially those which have already engaged in competitive privatisation programmes.

Measures by ACP countries

Theories of private investment emphasise the important of *country risk and timing* in addition to a high growth in demand for the goods or services in determining investment flows both by local and foreign nationals.

Problems of investment divide into *political risk* (wars, civil disturbance, politically motivated pressure on private and/or foreign property rights) and *transfer risks* arising from restrictions on remitting funds back to the home country of the investor, or losses in doing so due to the devaluation of the host countries' currency. Indicators of transfer risk, such as the Economist Intelligence Unit (EIU) index, emphasise macro-economic policy (debt ratios and debt management, economic growth, strength of the overall balance of payments) and the credibility (basic, lasting reforms) of these policies (often using the degree of openness of the economy as an indicator, on the basis that the international market acts as an automatic 'discipline' on government policies).

Timing of investment is important because investment returns are always uncertain and once made are either difficult or impossible to reverse and therefore carry an opportunity cost (returns which could have been earned from an alternative investment project). The literature sometimes talks of 'first movers' and second movers', with the former being the pioneers who take the highest risk and develop the ground for the latter to move in quickly if the pioneers' experience is favourable (or fail to invest if the former's experience is unfavourable).

With these factors in mind, the ACP countries may wish to review Articles 273 (on currency payments and capital movements) and

274 (treatment of business entities).

Art. 273 states that:

'the Contracting Parties shall refrain from taking action in the field of foreign exchange transactions which would be incompatible with their obligations under this Convention resulting from the provisions relating to trade in goods and services, establishment and industrial competition'.

Does this mean that there is free movement of capital or earnings for foreign investors or not?

Also:

'These obligations shall not, however, prevent the Contracting Parties from adopting the necessary protective measures should they be justified by reasons relating to serious economic difficulties or severe balance of payments problems'.

Since, short of arbitrary restrictions, this is exactly the situation which foreign investors are concerned with, this caveat simply nullifies any guarantee contained in the first statement and, if anything, confirms their worst fears on investing in ACP countries.

A more constructive approach would be for ACP countries, or groups of countries to give clear undertakings covering transfer risk, ideally backed by EU financial guarantees, and these guarantees could perhaps be separately signed as a protocol to a new agreement.

Similarly, Article 274 allows for 'national treatment' of foreign firms, however, 'if for a given activity, an ACP State or a Member State is unable to provide such treatment, the ACP State or the Member State, as the case may be, shall not be bound to accord such treatment for that activity to the nationals and companies or firms of the State concerned'. In plain English, this means that 'you can have national treatment except where we decide you can't have national treatment, with no guarantees of how this might change in the future. The same objection applies to this as to Article 273 – what

'signals' are these provisions of the Convention supposed to be giving to potential foreign investors? It would be far better for the ACP either to be given the financial and technical support of the EU to provide guarantees to EU investors or to omit such clauses altogether. As they stand they are at best useless and at worst, counter-productive.

A recent workshop which examined some of the possible reasons why FDI in Africa has not responded to macroeconomic and legislative changes (MIGA, 1996) highlighted some additional reasons:

- ❖ 'one-stop shops' have often been *additional* shops without the expertise or authority to make decisions on approvals;
- ❖ regulations are still widespread, onerous and haphazard creating uncertainties both for the foreign investor and the civil servants who have to administer the regulations;
- ❖ customs and port operations are singled out as being particularly inefficient, cumbersome and corrupt, causing high transaction costs and long delays in clearing imports and exports; and
- ❖ the legal and judicial system is outdated and ill-suited to the modern world and judges

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lack experience in dealing with corporate law and other economic matters.

6.7 Conclusions

All countries are subject to varying degrees of difficulty in attracting and regulating foreign investment, the problem in Africa, as compared to Asia or Latin America, is that the sum total of these difficulties facing foreign investors is relatively large and both their magnitude and effects are much more unpredictable. All of the ACP countries, including most of the least developed countries, could benefit from a greater focus in a new agreement on financial and institutional measures to encourage a greater volume and diversity of foreign involvement. This cannot be expected to be a major element in strengthening the competitiveness of most of the ACP countries since most FDI will flow to the larger and more industrialised developing countries, but it could provide key inputs which, as discussed at the beginning of this chapter, are not available from other sources. To be effective, such initiatives in a new agreement must be closely co-ordinated with other initiatives within an overall strategy for each ACP country which seeks to develop international competitiveness and not somewhat haphazardly put into a 'national indicative programme'.

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