

Sino-Africa Cooperation: Promoting an Enabling Environment for Higher Levels of Investment and Financial Sector Development

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Abstract:

After decades of marginalisation, global dynamics has surprisingly brought back Africa in the trajectory of global economic developments. These developments compel every players, on the global scene, including China, to re-adjust its engagement vis-à-vis Africa. In spite of persistent instability in some countries, the African continent is collectively moving towards a more enabling environment for investment. China has a bigger role to play today to promote stability and reinforce the enabling environment through greater support to regional integration, harmonized investment protection rules and cross border infrastructure projects. Higher involvement of Chinese financial institutions in Africa would bring sophistication, efficiency and depth to the African financial sector.

Key Words: Global Dynamics, Engagement, Enabling Environment, Investment.

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Over the last decade Sino-Africa Cooperation has witnessed a remarkable development as illustrated in several research papers, including the recent one released by the African Development Bank¹. This performance is the result of a well-thought Africa policy of China and the partnership programme agreed upon by both parties within the FOCAC process.

The engagement of China with the African continent has been conducted mainly through the bilateral channel with individual African States and often centred on some large infrastructure projects. This approach has undoubtedly resulted in tangible positive outcomes both for the African States and China.

Developments in the recent years, both on the global scene and in Africa, tend to suggest that the existing approach, though comprehensive, needs to be complemented by, on the one hand, stronger engagement of China at the continental and sub-regional levels and, on the other hand, the introduction of new instruments that can reach a wider spectrum of organizations and individuals.

This paper will limit itself to the area of investment and financial sector development, as a modest contribution to the wider challenges of enhanced China-Africa Cooperation.

1. THE REPOSITIONING OF AFRICA IN THE GLOBAL DYNAMICS

For most of the last quarter of the 20th century Africa has been underperforming with respect to other regions, so much so that there was growing consensus that its marginalisation from the globalising process was inevitable. With the turn of the century global dynamics has surprisingly brought back Africa in the trajectory of global economic developments².

First, the pace of global economic growth, especially in the emerging economies, has resulted in an escalation of the cost of raw materials, especially minerals and energy. The world has been reminded that in spite of issues of access, logistics and political instability, Africa has considerable reserves of minerals and fossil energy, with significant additions in recent years, thanks to new discoveries.

Second, the food crisis of 2008 has suddenly brought to light the challenge of feeding a world population of 7 billion. With a population expected to reach 10 billion in the next century and the expected increased per capita consumption of food in major emerging economies, it is clear that existing major production centres alone will not be able to cope with a challenge of this dimension. Again, we are reminded that Africa has 60% of the share of world total amount of uncultivated, arable land³.

¹ R. Schiere, L. Ndikumana and P. Walkenhorst (2011) *China and Africa: an Emerging partnership for Development?*

² Cheeroo, M. (2011) *Quand L'Afrique s'éveillera*, CCI Info (July 2011)

³ Mckinsey Global Institute (2010) *Lions on the move : The progress and potential of African economies*

The challenge of aging population in the developed countries and eventually in the emerging economies will inevitably make of the size of the working population a key element of future growth. It is estimated that Africa, with its current age profile, will have a working population of 1.1 billion in 2040.

And then climate change has taken centre stage in the growth scenarios of the future. The tropical forests of Africa were already a major asset in fighting climate change. It is important to note that, in addition, the unexploited sources of renewable energy in Africa are enormous. The implementation of the hydroelectric project of 'Inga', in the Democratic Republic of Congo, can alone satisfy the total demand of electricity of the whole continent and a location in Sahara Desert, indentified by the International Energy Agency, can produce solar power to meet the demand of the whole planet!

It is true that this huge potential of Africa has not been fully exploited in the past because of political and economic governance issues. But over the last decade, performance on both counts have been better than in previous decades. No wonder then that the Bretton Woods institutions are forecasting growth rates in Africa higher than the world average in the medium term⁴.

These developments in the global dynamics compel every player on the global scene to re-adjust its engagement vis-à-vis Africa. And this holds true also for China.

2. THE INTEGRATION PROCESS IN AFRICA

For four decades the dream of a 'United States of Africa', carried by the fathers of independence of the first African States, has been frustrated by internal wars, narrow nationalism and rivalries, exacerbated by intervention from foreign powers. Africa remained torn apart, except for some isolated success stories in political / economic integration (the Southern Africa Customs Union – SACU, the Eastern African Community – EAC, the Union Economique Monétaire de l'Afrique de l'Ouest – UEMOA).

However, the 1990s and, more significantly the turn of the century, witnessed an acceleration of integration initiatives, especially in the consolidation of regional economic blocs. This positive development has been supported by a major breakthrough in the field of peace and political stability (end of apartheid in South Africa, end of civil wars in Angola, Mozambique, Ethiopia, ...). But it was also the outcome of an emerging consensus in Africa that economic integration can be an answer to better reap the benefits of globalisation.

2.1 The 'Building Blocs' of the African Economic Community

The new environment of the 1990s, has triggered two major developments in favour of integration. The first is the new consensus, which was to be enshrined in the Abuja Treaty in 1991, that the integration of the continent will be achieved through a 'building blocs' approach

⁴ IMF World Economic Outlook, September 2011

rather than the 'Federal' approach advocated in the 1950's and 1960's. By dividing the integration of Africa in seven specific groupings (COMESA, SADC, EAC, ...), moving at their own pace and according to their own dynamics, the then OAU gave a new impetus to the integration process, although there might be other problems for eventually making the blocs merge into a common economic community.

The second important development has been the sequencing of the integration process, with the economic agenda, especially market integration, taking precedence over the political agenda, which has had the effect of significantly reducing the resistance to integration.

As a result of these two major developments, loose economic integration initiatives marked by non-fulfillment of obligations by many Member States, underwent a radical transformation over a bit more than a decade. All seven regions managed to put into place functioning FTAs (although not all Member States in various regions fulfilled 100% of their obligations), and a few had even launched their Customs Unions (although fulfilment of all obligations of a CU by all Members is still a distant goal).

2.2 The Tripartite Initiative

The decision of the Heads of States or Governments at the Summit held in Kampala in 2008, to launch the 'Tripartite Initiative', with a view to establishing an FTA which will include all Member States of COMESA, SADC and EAC, represents a major milestone in the constitution of the African Economic Community. Twenty-six states, stretching from Cairo to Cape Town, with more than half of the population and GDP of Africa have committed themselves to create one single market, and eventually one Customs Union. Although preparations to launch the negotiations for the FTA have taken longer than initially planned, the effective launch was made in June 2011 by President J. Zuma in Johannesburg. It is to be underlined that this integration process is being built on three pillars: market integration, infrastructure development and industrialization, with movement of persons on a parallel track.

2.3 The Continental FTA

The successful launching of the Tripartite Initiative has created a new optimism regarding the economic integration of the continent. For the first time, since the Abuja Treaty was signed in 1991, the proposal for the setting up of a continental Africa FTA has been put on the agenda of the African Union, during its last Summit in Addis Ababa in January 2012. This objective remains as daunting as it has been for decades. But it certainly appears more achievable to-day than ever before.

If global dynamics have created the compelling reasons for the world to bring back Africa in the global equation, the recent integration initiatives are undoubtedly promoting a more enabling environment for investment and financial sector development.

3. THE EMERGING ENABLING ENVIRONMENT FOR INVESTMENT

In spite of persistent instability in some countries (DRC, Somalia, Sudan,...) and recent disruptions in Northern Africa, the continent is collectively moving towards a more enabling environment for investment. And this movement is more pronounced on four counts.

3.1 Peace and Political Stability

Lasting peace and political stability are major pre-conditions for attracting growing levels of investment. In the absence of this ideal scenario, the nearest proxy is the establishment of mechanisms that can minimize risks of political instability and war and, if they do occur, to deal with them in an expeditious and effective manner.

On the one hand, there are today definitely more countries in Africa that are developing on the twin pillars of peace and political stability than two decades ago, which confers to Africa a much better composite picture of stability. On the other hand, mechanisms have been put into place to intervene in cases of instability or war. It is to be noted that the integration processes in Africa have provided added instruments to contain wars and instability. For example, in the case of Madagascar, the mediation initiatives at IOC, SADC and AU levels ultimately resulted in the roadmap being finally accepted by all parties, which should pave the way to a return to political stability and normalcy in the near future. Similarly, in the case of Ivory Coast, combination of military threats from the regional / AU / UN forces did pave the way for breaking the deadlock. Things would have probably been worse in Zimbabwe and some other African States for example the recent coup in Mali, in the absence of peer pressure from Regional Partners or the AU.

The political stability in Africa is still far from ideal. But the capacity of Africa to contain instability and war or to resolve disruptive situations has never been as strong as it is today. And this should be good news for potential investors.

3.2 Integrated Market

Investment beyond extractive industries has been very limited in African States because of the fragmented market and low purchasing power. We have mentioned earlier the great leap made recently in market integration and the real prospects for further integration in coming years, especially with the 'Tripartite Initiative'.

The integration initiatives will not only create larger integrated markets for consumer goods. They would unleash a huge market for the supply of integrated infrastructure and utilities.

As purchasing power develops (estimated at USD 1.4 trillion in 2020), the demand will justify 'delocalizations' to Africa of some major industries both to service the African market and third countries⁵, as has been the case for new emerging countries.

⁵ 'African Business', October 2011

3.3 Harmonized Investment Rules

A lot of attention has focused in recent years on the market access conditions in the various integration initiatives in Africa. There has been less emphasis on the Trade-Related Issues, given the known position of African States on those issues in international fora, especially in the WTO. Quite surprisingly, in their integration initiatives, African States have gone quite far in Trade-Related Issues, including the ‘Singapore Issues’.

One specific development to promote investment has been the establishment of harmonized investment rules. One such example is the ‘COMESA Common Investment Area Agreement’, adopted by twelfth Summit of COMESA in May 2007 in Kenya. Although to date not all the COMESA countries have signed and ratified the Agreement, this regional framework agreement gives to investors a new perspective for investment in the COMESA Region.

Similarly, in the SADC Region, the ‘Protocol on Finance and Investment’, which was signed in 2006, contains eleven annexes which harmonize various activities in the investment and financial sectors. Other RECs, in Africa have their own initiatives to harmonize investment rules.

The harmonized investment rules as they develop and are applied across larger regions (the ‘Tripartite’ holds probably the greatest potential), will impact on the way investors will look at Africa.

3.4 The Resilience of the African Financial System

Although the African financial system is fragmented and ‘shallow’, it showed a lot of resilience during the recent global economic and financial crisis, given its limited exposure to ‘toxic assets’ and its low integration with the international financial markets. A recent survey of African banks concluded that “African banks have enjoyed mixed fortunes over the past year but there is no doubt that the sector as a whole is in a better shape than at this time in 2010”. Similarly African Stock Exchanges have been faring better than their counterparts in the developed markets.

In fact this underdevelopment and limited exposure of the African financial system, combined with the continent’s rapidly growing economies, offer strong growth potential for the sector⁶.

The inherent weaknesses of the financial sector in Africa are in fact being translated into an asset both for investors in financial institutions and those willing to work with them to invest in the real economy.

⁶ Fitch Ratings Special Report, September 2011

4. SINO-AFRICA COOPERATION TO UNLOCK THE POTENTIAL OF AFRICA

The new Africa which is emerging from developments over the last decade call for some adjustments in the Sino-Africa Cooperation to unlock the growth potential of Africa and accelerate the economic exchanges between Africa and China.

4.1 Greater Emphasis on Support to Regional Integration

Given the key role regional integration is playing in promoting stability and creating an enabling environment for investment and sustainable economic development, China should provide greater support to sub-regional organizations in their integration initiatives.

Although paragraphs 2.5.5 and 2.5.6 of the Sharm El Sheikh Action Plan⁷ do explicitly mention the need for the reinforcement of the partnership between China and the African regional organizations, the actual involvement of China in the integration processes is minimal. By contrast other International Cooperating Partners (ICPs) are heavily involved in these processes and they are, for example, all throwing their weight behind the 'Tripartite Initiative'.

In fact China needs not only to provide direct support to the Sub-regional organizations; it has also to assist individual Member States to address some of the challenges they face in participating effectively in the integration initiatives and in meeting the obligations attached thereto. Other ICPs are already active in this field. The value addition of China in this process can be much higher given the trust it enjoys among African States.

4.2 Investment Promotion and Protection

Although the Sharm El Sheikh Action Plan provides for the 'conclusion and implementation of bilateral agreements on investment promotion and protection' there will also be merit to promote harmonized investment promotion and protection rules, as discussed earlier, over larger regions to scale up the size and scope of investment. The unilateral 'Bilateral Investment Treaty' model of the USA, should give way to move flexible agreements which bring together several States, or even whole sub regions on a common shared agenda on promotion and protection of investment. Such initiatives, as mentioned earlier, exist already and they need to be supported.

This approach will have the benefit of not confining investment to specific projects or 'zones' but allows it to seep throughout economies with much larger spillover benefits.

4.3 Infrastructure Development

Infrastructure development is both a destination of investment as well as a catalyst for investment in other productive sectors. The significant investment of China in key

⁷ Forum on China (2009), Africa cooperation Sharm El Sheikh Action Plan (2010-2012)

infrastructure in many African States over the last decade has been of immense support to enhancing the investment environment in many parts of Africa.

With the integration initiatives in various parts of Africa, the time has probably come for consideration of cross-border regional infrastructure projects, on the model of the landmark 1,800 km Tanzania-Zambia railway project of 1970-75. Such regional infrastructure projects, alongside the 'development corridors' identified in various regional initiatives or under the NEPAD, have the potential to promote significantly higher investment and development than from the national projects.

4.4 Trade and Investment Facilitation in China

The market access offers towards LDCs in Africa contained in paragraph 4.4.3 of the Sharm El Sheikh Action Plan, has to be fast tracked so that Quota Free Duty Free access of 95% of exports of LDCs can be achieved as quickly as possible. Consideration has also to be given to the granting of preferential market access to other developing countries in Africa given the need both to balance trade flows between China and Africa and to dynamise bilateral business relations.

4.5 Greater involvement of Chinese Financial Institutions in the Financial Sector of Africa

The financial commitment of China to support investment in Africa is indeed impressive (USD 10 billion of preferential loans for infrastructure projects, USD 3 billion under the China-Africa Development Fund to support investment from Chinese businesses and USD 1 billion to support development of SMEs).

As mentioned earlier, the African financing sector is underbanked, fragmented and shallow. Beyond the financial resources, Africa needs also the expertise of Chinese financial operators to bring sophistication, efficiency and depth to the financial sector.

Cross listing of Chinese and African companies on their respective stock exchanges would also support the development of stock markets in Africa.

4.6 Engagement with the African Private Sector

The FOCAC process has had a business component, with high level business meetings both in Beijing and Sharm El Sheikh. There is need to complement these business relations with a structured dialogue mechanism with the representatives of organized private sector of Africa (at continental and sub-regional levels) to address issues of business development in general and investment and financial issues in particular.