"Mobilizing International Investment Flows: The New Global Outlook"

Speech to the Commonwealth Business Council

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Thank you for inviting me here today to address this meeting to discuss mobilising international investment flows.

Many of the lessons of economic development of the past 30 years are painful. Yet African countries have learned the lessons well, not least because our experiences have been learned at home.

Various efforts have been made to launch growth, and many different paradigms have been tried. Not one of them has solved the problem of growth and poverty reduction. And this has led us to realise that nothing that we have done up to now has been sufficient.

The lessons are many. Among them, we have realised that small, weak states are a hindrance to growth, despite what the neo-liberal paradigm tells us. At the same time, we have

realised that market liberalisation is critical to expanding economic opportunity for our people, despite what 'dependency' theory used to teach.

There are many other lessons.

But perhaps the most important is that to pull in international investment, we need as African economies, to generate our own investment.

Despite the enormity of aid flows and once-off investments in natural resources for many of our economies, these are necessary but simply insufficient to raise our living standards and growth rates.

Economic growth is impossible without an active, capable and well-governed state and private sector, just as poverty reduction is impossible without growth that benefits more than just a tiny elite.

Focusing on what Africa must do to pull in investment from abroad is critically important, but we must also recognise that we are small and mostly open economies that are subjected to shifts in investor sentiment and economic conditions in the rest of the world.

Although the global recovery is still expected to continue, growth in the second half of 2002 and in 2003 will be weaker than earlier expected - largely due to piecemeal policy-

induced increases in domestic demand in industrial economies.

The structural differences in the balance of payments positions of the US and the UK on the one hand, and the European economies and Japan on the other hand, are not conducive to a generalised increase in global growth.

Moreover, there is little evidence of a sustained rise in global investment, largely due to higher risk aversion among investors driven fundamentally by uncertainty about the economic path of the developed industrial economies.

This uncertainty is primarily created by the outlook for the Unites States, where the large current account deficit, poor corporate governance, volatility in equity markets and the medium-term fiscal outlook remain of concern. Germany and Japan do not appear to be providing any optimism to growth prospects.

Developing economies, moreover, have also been negatively affected by the slow-moving contagion arising out of Argentina and now spreading to Brazil and Uruguay. The Fund may have acted quickly enough to prevent a further spreading of Latin America's economic woes. Additional concerns arise from the Middle East, as is presently reflected in higher oil prices.

For developing economies, the current downturn in investment is driven by rising risk aversion. In the absence of changes to risk aversion, it would have been expected that investors would choose to place their money in comparatively higher yielding developing country assets. Unfortunately, this has not been the case, and suggests that in a global downturn, better performance of developing economies is not a safeguard against volatile capital flows and investment.

While it seems prudent to suggest that the actions of the fiscal and monetary authorities, especially in the US and the UK, to the current downturn have been appropriate, it also seems difficult to avoid the concern that our international financial architecture is simply not working well.

As in the case of Africa's development, one is tempted to say that, while great progress has been made in making systemic and institutional efforts to stabilise the global environment, that progress remains insufficient.

Developing countries remain at risk from destabilising capital flows, particularly those caused by changes in macroeconomic variables in developed regions, while developed countries themselves seem unable to boost productivity and growth.

In large part, this global problem stems from our collective unwillingness to recognise financial disequilibria, especially those caused by excessive financial speculation in the Information Communication Technology markets.

The difficulty is that this speculation reaches such proportions that its bursting wreaks havoc on markets and economies across the globe. We do not have the multilateral financial architecture to address them- and that means that high levels of risk aversion and investor uncertainty will remain features of the global environment for some time to come.

Important steps to rebuilding a multilateral financial architecture could, in my view, include the following:

?? Increase the representation of systemically important developing countries in key international forums, including the FSF.

?? Increase the representation of developing countries in the governance structure of the IMF and Bank by raising the number of and importance of basic votes.

?? Reform the method of determining quotas to reflect sound policy, progress in policy reform and openness, not just GDP per capita.

?? Improve the Contingent Credit Line (CCL) to increase the attractiveness and automaticity of the facility.

?? The establishment of a formalised debt-restructuring framework.

?? Greater coordination in national macroeconomic policies (cross-regional annual meetings, say G8 + Latin America, G8 + Africa, etc.).

?? Better regulation of global financial and capital markets and improved regulation of domestic financial systems through new proposals by the G20 working with the IMF on appropriate capital account policy and supervision of capital inflows

A critical uncertainty in the present investment climate is when the next corporate scandal will come and in what major company. I noted a few months ago that a major US telecommunications firm had written off $30 billion worth of investment, which is equal to over 12% of all foreign investment in developing countries in 2000.

Corporate malpractice and irrational investment decisions, unfortunately, seem to go together. And while fortunately not endemic to the industrial economies, this corruption has been of sufficiently large scale and pervasive to put in question the probity of corporate governance and behaviour more widely.

Clear reforms, transparency, accountability, and effective implementation must guide the corporate reform effort in all countries. In South Africa, we have initiated a process of reform, beginning with a general acceptance of an independent code of corporate governance (the King Code of

Corporate Governance very similar to the outcome of the Cadbury Report in the UK). This was followed by a process of assessing compliance with international standards and codes, including those on corporate governance and auditing & accounting standards. This is being followed by giving legal backing to accounting standards and changing the governance of the accounting and auditing profession.

In some ways, the era of corporate reform and accountability that we are entering has been presaged by developments in Africa. As Africans, we have recognized, as I mentioned earlier, that sound economic governance must be a cornerstone for mobilizing domestic and cross-border investment.

The Capital Flows initiative of NEPAD is intended to provide opportunities for African economies to benefit from improved economic governance by setting up dear instruments for drawing-in higher levels of investment.

I want to just mention four parts of the Capital Flows Initiative that are intended to assist in drawing-in capital by strengthening the investment environment in developing countries. They are:

The NEPAD Debt Initiative, which will provide greater debt relief to countries linked to the Poverty Reduction Strategy Papers and HIPC Initiative. This will free-up fiscal resources

for developing countries, thereby enabling them to more quickly and effectively build human and physical capital through greater social, education and infrastructure spending.

Second, the ODA Reform Initiative, which will help in the process of harmonising the activities of donors and multilateral institutions, and make their financial assistance more effective. Lessons learned from country experiences will be generalised through a PRSP Learning Group and other NEPAD forums.

Third, is the NEPAD Private Capital Flows Initiative, which sets out a series of sub-initiatives to promote investment into Africa, including:

?? **undertake audits of legislation and regulation, which will form the basis of reforms to reduce at source the regulatory and political risks associated with doing business in Africa.**

?? **act on recommendations to mitigate risks associated with doing business in Africa**

?? **take steps to achieving the long-term goal of an African derivatives market**

?? **enter into a NEPAD initiative to enhance the capacity of countries to establish public private partnerships (PPPs)**

?? **establish a NEPAD Financial Market Integration Task Force, that will serve to fast-track financial market integration**

through the establishment of an internationally competitive legislative and regulatory framework.

While NEPAD represents a major step forward in terms of improving conditions for investment and growth in Africa, I believe that it is only fair to recognise that Africa has already made great strides in this area. Most of this progress has gone unnoticed by the international investment community, which tends to focus on the negatives.

For example, while many countries remain too vulnerable to price shocks, such as those currently hitting coffee and cotton, GDP growth is projected to pick up to 4.2% in 2003. In Sub-Saharan Africa, from 1994 to 2000, growth averaged 3.2%, the same average rate of growth as in the advanced economies.

Moreover, since the mid-1990s, macroeconomic stability has improved, with CPI inflation expected to fall to single digit levels in 2002, largely due to much-improved fiscal performance.

This improved economic performance reflects a long series of reforms instituted by African countries over the 1990s, including tariff reform, exchange rate management, public expenditure, governance, tax collection. Nonetheless, we cannot ignore the reality that there is much farther to go, and a number of very serious challenges facing us.

Sustained poverty reduction will require turning around low investment and savings, and the impact of conflicts and disease, weak institutions and infrastructure, poor governance, and low life expectancy.

Concluding comments:

Over the course of the 1990s, investment to developing countries has risen alongside the general trend of rising flows of funds away from traditional savings vehicles to equities. Net private capital flows to developing countries reached $230 billion in 2000, but 90% of this went to a few middle-income emerging markets, such as China.

The Commonwealth Business Council points out that by 1999, FDI flows into the 49 Least Developed Countries account for 11% of total investment.

Clearly, the current global economic environment is not favourable for major increases in investment flows to developing countries in the absence of a decline in investors' risk aversion.

This is especially regrettable since the investment opportunities in many developing countries are exceptional.

The Commonwealth Business Council has made a variety of thought-provoking suggestions on how to increase investment in developing countries.

While these proposals would go some way in inducing greater investment, I remain concerned that in the absence of broader changes to the international financial and developmental architectures, they will have only marginal effects.

In part, the marginal impact is due to the fact that some of the proposals ask developing countries to provide guarantees that they can ill afford. In my view, this serves to reinforce, not resolve, the critique of private investment, which is that it is 'cowardly,' fearing to tread where risk may be high. Of course, where risk is high, so is return, and clearly the far-sighted investor will reap the rewards of such investments.

I do not mean by this to shoot myself in the foot, but only to urge the Commonwealth Business Forum and the private sector more broadly to lobby developed country governments to live up to the commitments that they have made to improve the international economic environment. These commitments would raise the potential growth rate of developing countries far more than marginal investment incentives.

So, for your lobbying efforts, I would request that you focus on:

Ensuring that the HIPC Trust Fund is fully funded, and that provision is made for topping-up when exogenous shocks impact on countries' debt sustainability.

Pushing developed countries to meet their ODA commitments of 0.7% of GNP as rapidly as possible.

And, placing special emphasis on developed country governments to reduce tariff and non-tariff barriers on exports from developed countries, especially on agriculture and textiles.

It is about time that we change the global mindset that it is ok for developed economies to spend $350 billion a year on agricultural subsidies while total education spending in developing countries only amounts to $250 billion a year.

Thank you…