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Promoting Private Investment in Countries of the Economic Community of Central African States - ECCAS

HIGHLIGHTS

- Promoting structuring private investment should feature prominently in public policies
- Public governance weighs on investment decisions and its improvement hinges on a real political will
- Private sector development institutions should be more efficient
- Dialogue between the State and the private sector must be built
- Priority should be given to building skills through vocational training
- More developed financial systems are likely to foster access to capital and reduce costs
- Infrastructure development should seek to improve competitiveness and better integrate the regulatory dimension
- Tax systems should be cleared of excessive levies
- Harmonization of direct and indirect taxation within ECCAS should be continued

This first edition of the quarterly thematic review of the Regional Department - Centre (ORCE) is devoted to the issue of private investment in countries of the Economic Community of Central African States (ECCAS)[1].

Central Africa is one of Africa's richest regions in terms of its considerable natural resources. The level of wealth per capita is on average higher than in sub-Saharan Africa (SSA). Paradoxically, this wealth contrasts with the level of development, attributable to poor economic diversification caused, in particular, by the dominance of the oil sector. **The economy of ECCAS countries should be structurally transformed to unlock its potential and create conditions for a diversified productive base, allowing for strong and shared growth, vital for social cohesion and political stability. Such a process requires the implementation of structural reforms that foster private investment focussed on diversification-bearing sectors.** To help in the identification and design of these reforms, the Bank conducted a flagship regional study[2] on the private investment climate in ECCAS countries. This study, which will soon be posted on the Bank's website, consists of 10 monographs, one for each country in the region, and a regional report.

This note summarizes the study findings and recommendations, and draws lessons for the Bank.

ECCAS in Brief

- **Population:** 138,6 million
- **7 oil-producing countries:** 80% of regional GDP
- **Benefits drawn from natural resources** = 29% GDP
- **GDP per capita** = USD 1875
- **Private investment**: 11% of GDP

Challenges to Private Investment in ECCAS

The overall public and private investment rate is relatively high in ECCAS although it obscures significant differences between countries. However, it should be noted that these investments are not adequate enough to diversify Central African economies. The investment rate, illustrated by the ratio of Gross Fixed Capital Formation (GFCF) to Gross Domestic Product (GDP) stands at about 20% in ECCAS. However, these investments are more part of an effort to catch up on the accumulated infrastructure shortfall than to address an actual development vision aimed at improving competitiveness necessary to diversify the region's economies. Indeed, infrastructure choices do not adequately address the challenges faced by the private sector, which plays a key role in diversification. Also, the virtuous cycle of alternation between infrastructure investments and directly productive investments, those that contribute to the production of internationally traded goods, has not really taken root in countries of the region. Traditional foreign direct investment (FDI) and, more recently,

1 ECCAS comprises ten States including six members of the Economic Community of Central Africa (CEMAC) - Cameroon, Congo, Gabon, Equatorial Guinea, Central African Republic (CAR) and Chad. The four other States are Angola, Burundi, Sao Tome and Principe and the Democratic Republic of Congo (DRC).
2 The executive summary is available on the DARMS platform (ADF/BD/IF/2012/229)

investment from emerging countries essentially target the exploitation of raw materials and not enough local processing, hence the low impact on private sector development.

In ECCAS countries, with the exception of Cameroon, **the private sector is poorly developed and the productive fabric relatively tenuous.** Medium-sized enterprises, considered as those employing between 50 and 100 workers, are the "missing link" in this production system. In the Central Africa region, as in many African countries, the private sector is bimodal, comprising a large number of small or even very small businesses, on the one hand, and a limited number of rather large firms, on the other.

In several countries of the region, this reality is attributable in part to the Dutch Disease[3]. It is also ascribable to the policies so far implemented by the Governments of ECCAS countries with very little focus on the small- and medium-sized enterprise (SMEs) sector. Yet, the latter are key drivers of structuring investment and underpin diversification. Moreover, they are more vulnerable to the obstacles making investments risky.

In the region, these challenges are numerous. The most significant ones identified by the regional study are institutional and economic.

At the institutional level, private investments suffer from:

Weak public governance, which introduces uncertainty into the investor's economic calculation. Regarding economic policies, efforts are needed to ensure the consistency of decisions and their application as well. As illustration, from one finance law to another, the facilities granted to entrepreneurs and investors may be cancelled without explanation. Governments often fail to comply with/implement laws and regulations. Legal institutions are weak and are often unable to ensure legal and judicial security which conditions investment and the development of economic activities. Under such conditions, it is difficult to escape corrupt practices.

Weak Private Sector Development Institutions: These institutions are often not provided with the necessary human, technical and financial resources to accomplish their mission. In addition, overlapping responsibilities between the various bodies render them less effective. For their part, investment promotion agencies are too frequently taken up by the "one-stop-shop" function and are not sufficiently involved in activities designed to sensitize Governments on reforms and provide advice to the authorities to improve the investment climate, identify and publicize investment opportunities and partnerships with the local private sector to the outside world. The profile and skills of workers in these institutions are often not adapted, in the absence of a private sector-oriented culture. Chambers of commerce are inadequately empowered to promote production. They must gain more legitimacy with their members and develop their financial autonomy. Professional business-support services are in most cases unavailable in these institutions.

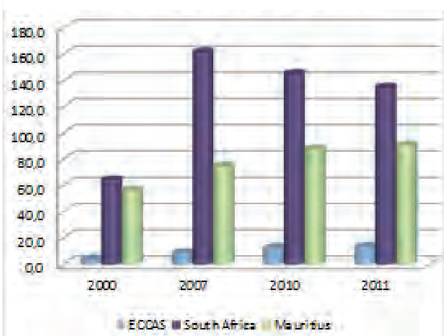
Limits of Public-Private Dialogue: In most ECCAS countries, public-private dialogue is still budding. Institutional frameworks are too fragile, non-existent or nascent to be effective. Dialogue is rare and not articulated on a common development vision. Within the public administration, dialogue is not sufficiently built. The private sector is itself weak, rarely supported by institutions in the various facets of its diversity and aspirations. The representativeness of SMEs is often insufficient. Hence, their interests are not adequately factored into public policy.

The Economic Environment also Weighs Heavily on Incentives to Invest. The challenges include:

Labour Productivity: Labour cost is highly heterogeneous within ECCAS, compounded in several countries by the effects of the Dutch Disease. To illustrate, the minimum wage varies from 40 to 45 dollars per month in the CAR, Cameroon and DRC, and is up to 240 and 300 dollars in Equatorial Guinea and Gabon. The challenge arises more in terms of the ratio of wages to productivity, especially in processing activities. Labour markets sorely lack technical skills due to the mismatch between educational systems and the employment needs of businesses. The result is additional costs for investors who have no other choice than to resort to expatriate labour to bridge gaps in the local skills base. However, restrictions on freedom of movement and right of settlement of persons observed in some countries in the region hinder access to skills potentially available at the sub-regional level.

Availability and Cost of Capital: The ratio of private sector credit to GDP in ECCAS is low despite the progress in recent years. This ratio illustrates the low access of businesses to financing. In Sao Tome and Principe, it rose from 4% in 2000 to 38% in 2011. In Angola, it increased from 1.2% to 21.8% over the same period. Conversely, the ratio remains relatively low in Chad (6.2%), DRC and Congo (less than 8% in 2011) and Equatorial Guinea (7.5%). In

Credit to the private sector, % of GDP



some oil-producing (Equatorial Guinea) or mining (DRC) countries, the private sector, however, enjoys very little local financing, especially for investments with a return over a long period. In the CEMAC zone, long-term loans accounted for an average of 3% of total loans for the period 2002-10. Banking services are characterized by high costs even if the average cost of credit stood at 11% in 2010, down significantly from 2005. In general, for a two-year maturity, the rates vary between 14% and 15%. In ECCAS, the difficulty of access to

[3] Principle according to which revenue, in this case from the hydrocarbons sector, spreads to non-hydrocarbons sectors exposed to international competition, especially induced by higher wages. Because this wage contamination affects the entire economy, the tradable goods sector can no longer withstand the evolution of induced costs; hence investment in diversification areas is blocked.

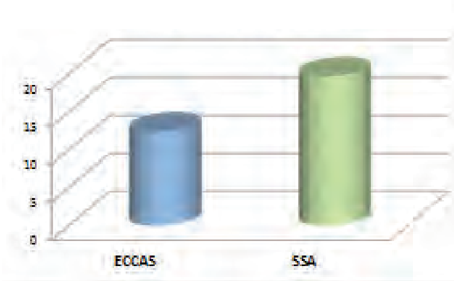
financing stems from the weakness of financial systems offering a very limited range of financial products. In this case, non-bank financing for private businesses is virtually non-existent. The coexistence of two stock exchanges in the CEMAC zone does not allow for optimal exploitation of the stock market potential. The challenge of financing can also be explained by the asymmetry of information on businesses which increases lenders' risk aversion. Lastly, it is due to the regulatory and institutional frameworks that do not provide sufficient protection of creditor rights.

High Electricity Costs: High electricity costs are another disincentive to diversification-oriented investment. In Chad, energy distribution is a major challenge for businesses. Over 75% of them use generators which cover 70% of business needs. Businesses undergo an average of 22 power outages monthly (double that of sub-Saharan Africa) and the shortfall related to electricity sector inadequacies is estimated at 8.8% of the turnover of businesses, compared to 6.7% in sub-Saharan Africa. In Congo, close to 33% of businesses name electricity as a major obstacle to business development. Power outages are frequent, more than 25 per month. In this context, 82% of businesses have generators that cover 56% of their needs at high costs. In Gabon, the power supply sector has not kept pace with the growth in demand. Therefore, whereas the production cost of a kilowatt/hour by the Société d'Energie et d'Eau du Gabon (Gabon's Energy and Water Corporation) [SEEG] is CFAF 70, that produced by a generator stands at CFAF 120.

The Cost of Connectivity via New Information and Communication Technologies (NICTs): The digital "gap" is yet to be bridged in the ECCAS zone. However, mobile telephony renders this gap less damaging to economic development. Where it does exists, Internet access remains prohibitively expensive and does not facilitate investment. For instance, for a large hotel in N'Djamena, subscription stands at CFAF 3 million per month, which is about USD 6,000 against CFAF 1.4 million for an establishment of comparable size in Douala, Cameroon.

Transport Costs: The region is characterized by low road density. The two landlocked countries, Chad and CAR, are most vulnerable to anomalies in port activities and inland transport. According to BDEAC, transport costs along the 1735 kilometres of the N'Djamena-Douala corridor are several times higher than the cost of shipping between Shanghai and Douala. The cost of shipping a container from the United States to Douala is the same as that of transporting the same container from Douala to Yaounde. The cost per kilometre is estimated at USD 3.19 from Douala to N'Djamena, USD 3.78 between Douala and Bangui, compared to only USD 2.22 between Mombasa and Kampala. Shortcomings in the logistics chain contribute to high transport costs.

Road density (KM/100KM)



Taxation: Within ECCAS, taxation is often burdened by informal levies not provided for by the finance law. This causes a significant strain on the formal sector. In terms of indirect taxation, the 15% -19% ceiling set by CEMAC is not always applied. Regarding direct taxation, the corporate tax rate ranges from 25% to 40% in the CEMAC zone. Outside CEMAC, tax rates for the four countries are at the same level: Angola (35%), Burundi (35%), DRC (40%), Sao Tome and Principe (32.5%). These rates are somewhat high compared with those practised globally.

Recommendations for Addressing Private Investment Challenges in ECCAS

In recent years, ECCAS countries have acquired relative macroeconomic stability which, to be sustainable and consistent with the inclusive development framework, requires the deepening of structural reforms. **These reforms should focus on the promotion of private investment and the lifting of barriers to diversification. They should also be part of an approach aimed at enhancing the efficiency of public administration.** Specifically, the study came up with the following recommendations.

Public action to promote structuring private investment should be strengthened in all countries of the region. Public policies should increasingly foster partnerships between large companies and SMEs to facilitate spill-over effects. In this context, subcontracting exchanges need to be promoted (Box 1). In light of the region's attractiveness for foreign investment, owing to its natural resource wealth, governments should ensure that partnerships, including with emerging countries, are part of the dynamics driving local private sector development.

The quality of public governance which weighs on the investment decision should be improved. Overcoming this impediment requires: (i) transparency in decision-making as well as the involvement of stakeholders in public and private sectors to enhance ownership, (ii) consistency in decisions taken by Governments, (iii) compliance with, and application of laws and regulations, (iv) greater accountability within public administrations, and (v) strengthening of the judicial system to increase investor protection.

The institutional private sector development climate should be more streamlined. In most countries in the region, it is necessary to consider: (i) streamlining the institutional environment, particularly through the redefinition of the mandates of various structures, (ii) strengthening the human, technical and financial resources of these institutions, and (iii) developing a service culture in business (Box 1).
State-private sector dialogue, essential to creating a favourable investment climate,

should be built. The embryonic nature of this dialogue in most countries in the region requires actions towards its institutionalization. However, to be effective, this dialogue must first be built within each of the parties. Its consolidation requires: (i) proper structuring and organization of representatives of each of the parties, (ii) appropriate private sector representativeness, and (iii) ownership of the dialogue platform by its actors, implying that its financing is supported by stakeholders such as the State and the private sector. Successful dialogue also requires the capacity building of employers' organizations and trade unions to enable them contribute effectively to the formulation of reforms.

Box 1 - Promising Experiences

Subcontracting exchanges in Chad and Angola - In **Chad**, the Chamber of Commerce has partnered with the Esso oil company through the Local Business Opportunity Initiative to provide business opportunities to local service firms. There are similar moves in **Angola** between the Business Support Centre (CAE), established at the Chamber of Commerce, and the public corporation, Sonangol. CAE provides training to businesses likely to be involved in the oil sector and ultimately grants certificates allowing them access to works contracts available in the sector.

The Burundi Business Incubator (BBIN) - In **Burundi**, an incubator structure is being established. This is an institution designed to facilitate the development of small- and medium-sized enterprises. On the same spot, BBIN allows the entrepreneur to access a wide range of business services including office automation, accounting and project financing arrangements. Despite BBIN's still limited capacity, this structure sets the pace that other ECCAS countries should consider.

Labour productivity must be stepped up. The answer to this challenge lies in training, especially vocational training, which should preferably be part of a regional approach given that each country's needs are such that a national response would be costly for them individually. Regarding the provision of training, specialized schools or institutes should be promoted at the regional level. To address the rigidity of labour markets, labour codes should be attuned to labour market needs in the context of economic diversification.

Access to capital should be facilitated and costs reduced. In ECCAS, the problem of access to financing is structural. Therefore, the solution is a long term one and hinges on improving the general economic environment and especially improving the quality of regulatory and institutional frameworks. The recommended actions include: (i) improving enterprise certification and accountability procedures and creating central balance sheet, risks and payment incidents data offices to reduce the information deficit, (ii) strengthening creditor protection with effective mortgage management services in order to safeguard information on assets, (iii) developing non-bank financing mechanisms (leasing, venture capital, guarantee fund) to diversify financing sources, and (iv) strengthening the judicial system. Efforts should also be made towards the rapprochement or merging of the Douala Stock Exchange and Central Africa Stock Exchange (BVMAC).

Infrastructure quality should be improved and prices reduced to support the competitiveness and ex ante profitability of investments. Infrastructure solutions are material but also depend on the capacity to maintain and regulate services in a transparent and equitable manner, including at the regional level. Regarding transport, in addition to efforts to build basic infrastructure, it is also necessary to focus on the entire supply chain (customs clearance process, timelines and consignment tracking, etc.), and promote multimodal transport. Actions related to trade facilitation at the corridors should be strengthened. With regard to ICTs, the deployment of optical fibre is expected to bring down costs by 25% to 50%, depending on the time horizon under consideration. The interconnection of electricity grids should ultimately offer enormous potential for the region, including the achievement of economies of scale. Public-private partnership is indispensable in addressing the infrastructure challenge.

Lastly, to solve the problem of administrative harassment and incidental taxation that weighs heavily on the investor, the fragmented nature of administrations and existence of different power centres should be addressed. Such a reform will be difficult to materialize without real political will and not merely through legal instruments. The quality of public service must be a core concern. Countries should have in place an action plan for the elimination of administrative bottlenecks. One possible transitional measure would be the establishment of a one-stop shop for taxes and non-custom duties. Regarding formal taxation, it is crucial to pursue a goal of harmonization of VAT rates and a gradual reduction of the rates currently charged, taking into account the ceiling set by CEMAC. Further harmonization of the CEMAC/ECCAS Common External Tariff (CET) will also be critical for regional trade integration in this area.

Findings of the study show that there are numerous challenges, remedies to which can in part be found at the regional level. This calls for a stronger commitment by ECCAS and CEMAC to improve conditions necessary to diversify the economy. Thus, these two institutions must speed up harmonization and streamlining of their agendas by incorporating innovative initiatives that contribute to establishing the ECCAS area as a space with remedies for the challenges to diversification-oriented private investment.

Bank Responses for Private Investment Climate Improvement in ECCAS

The Bank is active in supporting ECCAS Member States (RMCs) and Regional Economic Communities (RECs) to improve the private investment climate. The Bank's strategic thrusts in the region aim to: (i) bridge the infrastructure gap which is the source of additional costs and loss of competitiveness, (ii) improve the functioning of public administration in terms of management, transparency and accountability, (iii) strengthen regulatory frameworks, and (iv) build institutional and human capacity.

With regard to improving the business climate, the Bank's interventions aim particularly at strengthening: (i) justice, (ii) the land tenure system, (iii) the banking system, (iv) technical education and vocational training, (v) institutional and regulatory frameworks related to business creation and public-private partnership, (vi) public-private dialogue forums, and (vii) procurement systems.

In addition, the Bank intervenes in **the capacity building of RECs** with the aim of providing them with the necessary resources to implement regional integration programmes. Within the framework of its ECCAS and CEMAC capacity building support programme approved in December 2012, the Bank will also support the harmonization of the CET of CEMAC/ECCAS.

In the medium term, the Bank is also expected to contribute to **enhancing financial integration** through the establishment of regional lines of credit and rapprochement of the Douala Stock Exchange and the Central Africa Stock Exchange.

In terms of infrastructure, the Bank's support to the region is mainly directed towards energy and transport sectors through: (i) the construction of power plants, (ii) the construction and rehabilitation of electricity distribution networks, (iii) the interconnection of electricity grids, (iv) the construction of corridors and rehabilitation of infrastructure to improve access at the national and regional level, and (v) transport facilitation. In the ICT sector, the Bank is expected to step up its activities in the medium term with the interconnection of high-speed optical fibre telecommunications networks among several countries of the region.

The findings of the regional study show that efforts must be scaled up to improve the private investment climate. If the Bank is already engaged in this process, the constraints analysis points to the need to strengthen certain actions, particularly with regard to:

(i) dialogue and sensitization actions for RMCs/RECs on the challenges of diversification based on diagnostic tools, in the light of the regional seminar;

(ii) public-private dialogue within which policy guidelines can actually be developed for sustainable growth, driven by the private sector;

(iii) the development of technical skills through vocational training focussed on diversification-enhancing sub-sectors from a regional perspective;

(iv) the development of financial markets to channel revenue from the exploitation of natural resources to diversification investment;

(v) sector governance to consolidate infrastructure assets and ensure equitable and transparent regulation at the national and regional level.

Box 2 - Dialogue with RMCs and RECs during the Regional Seminar on the Theme: "Promoting Private Sector Development in ECCAS Countries"

Held on 28 and 29 November 2012 in Libreville by the ORCE Department in collaboration with the African Development Institute (ADI), the seminar provided the opportunity to interact with RMCs, ECCAS, CEMAC, and the private sector on the issue of private sector development and challenges to private investment in the region. It was attended by about fifty persons from 10 countries who unanimously requested that the work be extended to each country of the region.