Executive Summary

Introduction

The Cotonou Partnership Agreement (CPA) endorses both the goal and strategy of development of the West African and other African, Caribbean and Pacific (ACP) countries, and provides for co-operation in the form of support for investment and the enhancement of private sector development in these countries. The Agreement only sets the stage for co-operation; its precise framework and the forms it will take will be the subject of negotiations for economic partnership agreements (EPAs) between the European Union (EU) and ACP regional sub-groups. These negotiations will determine the specific forms of co-operation in the areas of investment and private sector support, as well as how such co-operation will be incorporated into the EPAs. The ACP regional groups obviously have an interest in ensuring that the investment and private enterprise component of the negotiated EPAs will promote, protect and guarantee the flow of domestic and foreign direct investment (FDI) to ACP countries.

This study examines ways in which the investment instrument under the ACP-EU co-operation arrangement can be strengthened, with particular reference to the countries which make up the West African EPA negotiating group. There are three activity blocks. Under the first, the terms of reference require a review of the demand and supply sides of the investment equation in West Africa; a description of various aspects of the domestic investment framework within a selection of countries in the region; and a review of the role of past and present bilateral or regional arrangements and treaties and their impact on attracting investment to the region.

Under the second block, the focus of the terms of reference shifts to an examination of the role of a range of international and regional development institutions and an exploration of how their support for investment and enterprise development can be enhanced. More specifically, the terms of reference require:

- A review of the enterprise development role of multilateral institutions such as the International Finance Corporation (IFC) and the Foreign Investment Advisory Service (FIAS); the relevant regional development agency, the African Development Bank (ADB); and ACP-EU related institutions such as the European Investment Bank (EIB), the Centre for the Development of Enterprise (CDE) and PROINVEST;

- Consideration of whether these institutions compete with, or complement, the services provided by private sector financial and investment institutions in the region;

- Consideration of how these institutions and their interventions could complement one another, including consideration of an appropriate mechanism for private sector partnership between the regional and EU institutions;

- An assessment of the adequacy and effectiveness of current ACP-EU measures to promote, protect and guarantee investment;
- The incorporation of a review of an intervention by the EIB, the CDE or PROINVEST in the private sector and the lessons learned from the intervention;
- Consideration of the potential of measures such as the 'lowering the threshold' proposal and the World Bank's Mozambique small and medium-size enterprise (SME) initiative in terms of promoting, protecting and guaranteeing investment.

Under the last of the three activity blocks, the terms of reference focus on the options, elements and measures which could feature and be reflected in the investment component of the EPA negotiations. In particular, the terms of reference call for:

- The identification of elements and options to be considered in negotiations on investment in the context of EPAs;
- The identification of areas of existing investment prohibition and/or sensitivity and areas of potential concession for the region in investment negotiations; and
- Proposals regarding appropriate measures that could be undertaken for promoting, protecting and guaranteeing investment, within the terms of the Cotonou Agreement, for inclusion in an investment agreement.

ECOWAS economic performance and investment patterns

Analysis of average output growth performance shows that the overall output growth performance in the Economic Community of West African States (ECOWAS) was approximately 1 per cent in 1980–1985 and 3.2 per cent in 1985–1990. Regrettably, in 1990–1995 average output growth fell, while it rose again in 1995–2001. The analysis therefore shows that average output growth performance has been less than the 7 per cent required for poverty reduction as recommended in poverty reduction strategies such as the Millennium Development Goals (MDGs) and the New Partnership for African Development (NEPAD). Despite this, Cape Verde, Benin, Burkina Faso, Senegal and Côte d'Ivoire are identified as emerging ECOWAS growth drivers by this analysis.

Overall analysis reveals that in the 1980–2002 period, the services sector led in terms of its share in total output in most ECOWAS countries (in both least developed countries (LDCs) and developing countries). This implies that the industrial sector contributed the least in these countries, showing that all efforts at promoting industrialisation in ECOWAS countries, particularly those aimed at attracting investment into the industrial sector, have yet to produce results.

Furthermore, reform programmes (especially privatisation programmes) implemented in ECOWAS countries appear to have boosted private investment, as it continues to outperform public investment. However, after taking into account FDI, the savings-investment gap that remains to be filled is large.

The domestic investment framework

The domestic investment framework of West African countries reflects the evolution of their local and foreign investment policies. From the early 1960s, these policies showed considerable ambivalence towards foreign investment. But with the start of policy reforms from the mid-1980s, a radically new approach began to emerge which allows foreign participation in an increasing number of economic sectors. In general, West African countries have moved from a rigid foreign investment environment in the 1960s and 1970s to the promotion of foreign investment since the mid-1980s.

The domestic legal framework for investment in the typical West African country is embodied in an investment code or similar legislation which offers protection to investors by eliminating various controls, ensuring equality of treatment among foreign investors and reduced discrimination between local and foreign investors.

Typically, the investment legislation also specifies entry and establishment conditions for foreign investment, regulation of ownership and operations, and incentives, as well as dispute settlement mechanisms. The principal elements of entry and establishment conditions relate to access to certain activities and capital requirement. These are often supplemented by special sector-specific investment rules, especially relating to mining activities. Measures for regulating foreign investment range from operational permits to performance requirements, with the latter focusing on the use of local labour and other resources.

Investment legislation in West African countries offers various incentives to attract foreign investment. The legislation also specifies how disputes arising from the relationship between private investors and host governments should be resolved. Investment dispute settlement arrangements include the use of domestic courts, the provisions of bilateral investment treaties, and regional and multilateral mechanisms, especially the Multinational Investment Guarantee Agency (MIGA) and the International Centre for the Settlement of Investment Disputes (ICSID).

While West African countries have made significant moves to progressively liberalise their foreign investment regimes, they have retained the right to use selective intervention measures as a means of internalising foreign investment benefits. Investment liberalisation in the region is a continuing process and hence many of the remaining restrictions may eventually be phased out.

Bilateral and regional investment arrangements and treaties

Investment treaties are products of the historical search for modalities for dealing with the entry and treatment of foreign nationals. Since the adoption of the first bilateral investment treaty (BIT) in 1959, the number of such treaties has grown substantially, reaching 1,857 by 2000. The ECOWAS countries plus Mauritania entered into around 59 BITs with 14 EU countries between 1960 and 2000. Twenty-three of these were entered into before 1980, while the rest were signed between 1980 and 1 January 2000, 22 of them in the 1990s.

The overall response of FDI to BITs did not show any significant change over the period analysed in this section. Many countries in the West African sub-region actually experienced a decline in the flow of FDI and in other countries trends showed no significant difference following the signing of a treaty. Mali, however, witnessed explosive positive FDI performance following the signing of an investment agreement. On the regional front, investment issues have for many years been part of the international negotiating agenda, and for many the subject has proved difficult in terms of reaching consensus. Investment inflows to ECOWAS member states plus Mauritania have witnessed significant, but inconsistent, growth since the initiation of the Lomé Conventions, especially the third and fourth series, which were specific in terms of provision for agreements on investment. Investment performance was very significant under Lomé III and IV, probably due to the specific emphasis on investment. The investment issue is more interesting under the Cotonou Partnership Agreement in that it sets detailed guidelines for investment in a comprehensive manner similar to that contained in BITs. It is not impossible, therefore, that investment provisions will be more effective in terms of FDI flow to West Africa under the CPA.

International institutions and enterprise development in West Africa

Various regional and multilateral development agencies and financial institutions have embraced enterprise development and a focus on the private sector as a means of promoting economic growth and poverty reduction in West Africa. Prominent among these are the World Bank Group, the ADB and the ACP-EU institutions.

The World Bank Group seeks to promote enterprise development by bringing together technical and management expertise, financial resources and information to assist local and foreign investors. The Group's lead agencies in this endeavour are the IFC and the FIAS. The IFC uses a market-based approach to assisting private enterprises by providing equity and debt finance, as well as offering advisory services and technical assistance. The FIAS assists governments in improving the environment for foreign investment through its advice on laws, incentives, strategies and institutional arrangements for increasing foreign investment and enhancing its benefits. The ADB supports private sector development through direct investment and financing activities by complementing the activities of private financiers and other development partners, and by encouraging improvements in the policy, regulatory and other elements of the enabling environment for private sector development through policy-based lending.

The ACP-EU institutions also have a mandate to support private sector development. The Lomé Conventions gave considerable priority to industrial co-operation and to the financing and promotion of investment, and this has been carried over into the CPA. There are a wide variety of instruments of intervention and support for private sector development within the framework of ACP-EU co-operation. These range from the EIB, which invests in and finances private enterprises in ACP countries, to such institutions as the EU-ACP Business Assistance Scheme (EBAS), CDE and PROINVEST, which provide technical, managerial and other non-financing support.

Up to mid-2004, the IFC had supported a total of 234 enterprises in West Africa with a total sum of US$1.91 billion. The distribution of these enterprises is skewed in favour of the region's largest economies. The FIAS has implemented a total of 67 study and advisory projects in West Africa, focusing particularly on the administrative and related barriers that inhibit foreign investment flows and on a review of investment policy. During 2002–2004, the ADB extended lines of credit for $430 million to private sector development projects; lending to financial institutions for on-lending to private enterprises accounted for 57 per cent of the total amount.

In West Africa, EIB financing between 1999 and 2003 amounted to just over €336 million; this represents 20.7 per cent of its commitments in Africa and 16.7 per cent of those in all ACP countries. EIB financing in West Africa over this period was heavily concentrated; its distribution does not appear to reflect the relative sizes of individual West African economies or the sizes of their SMEs.

To the extent that these multilateral, regional and ACP-EU institutions are supporting the same clientele, an inherent degree of competition between them is probably unavoidable; this may not be bad if it induces efficiency in supply and permits choice in demand. In spite of this inherent tendency to compete, however, there is a strong commitment among the institutions to collaborate and thus complement one another. Within the array of ACP-EU institutions, there appears to be little collaboration between the EIB on the one hand and CDE and PROINVEST on the other. In addition, it is difficult to establish the absence of any overlapping or duplication in the services provided by CDE and PROINVEST. The fragmented nature of support provided by ACP-EU institutions constitutes a significant weakness in their assistance to private sector development.

There is some concern that EIB funds may displace other local and foreign private investment under certain conditions. Analysis of EIB-funded projects in West Africa suggest that such 'crowding-out' may occur with respect to large private enterprise projects supported by EIB funds in West African countries which have sufficiently strong equity markets to offer adequate alternative financing. By comparison, EIB funds which support 'commercially operated' large public sector infrastructural projects are unlikely to displace feasible local private alternative financing; they may in fact assist in 'crowding-in' local private investment. Similarly, EIB funding of West African SMEs through global loans to local banks and stakes in local capital venture companies is associated with 'crowding-in' effects, as the local financial institutions are induced to increase their term financing of SMEs.

In general, West African SMEs require significant technical assistance combined with appropriate financing as two interwoven and complementary prerequisites for sustained growth and enhanced developmental impact. But the lack of an integrated approach to the delivery of financial and technical assistance to the private sector by the ACP-EU institutions sharply reduces the complementarity gains between the two assistance components. The Mozambique SME initiative developed by the IFC provides a useful lesson for the ACP-EU institutions in this regard.

Investment negotiations in the economic partnership agreements

Several factors were considered in predicting the nature and form of the envisaged investment component of the West Africa-EU EPA. These included existing domestic investment regulations, bilateral investment treaties, regional investment treaties, multilateral investment agreements, the size of West African countries and the experience of West African countries in over three decades of trade co-operation with the EU.

While current unilateral investment liberalisation has removed restrictive measures and eliminated discriminatory laws maintained against foreign investors, the bilateral investment treaties signed by West African countries have generally obliged them to encourage and create favourable environments for EU nationals or companies to invest capital depending on existing laws; to ensure fair and equitable treatment and full protection and security of EU investment; and to discourage expropriation. In a similar fashion, the CPA and Lomé III and IV require parties to take account of non-discrimination between investors of the parties and third countries, though issues relating to the most favoured nation (MFN) principle, expropriation, transfer of capital and international dispute arbitration were left to further research.

By analysing certain regional agreements of the EU and juxtaposing this analysis with the size of West African countries and the differing objectives of the latter as net importers and the former as net exporters of capital, the character of the investment component of the West Africa-EU EPA is predicted according to two scenarios. In the first, it is envisaged that the investment provisions of the West Africa-EU EPA will bear a close resemblance to those of the EU-Mediterranean agreements. Under this scenario, the agreement would contain investment promotion provisions that stress co-ordination and co-operation, as well as investment promotion measures in terms of harmonisation and simplification of procedures, creation of joint ventures, establishment of co-investment machineries and provision of technical assistance and, perhaps, the establishment of a favourable bilateral legal framework and the development of uniform procedures for promoting investment. The investment protection provisions would not be strong and the EU would prefer to leave investment protection issues to BITs with EU member states. New restrictions to current payments and capital movement would not be allowed and existing restrictions on them would be progressively liberalised over time.

There would be no limitation to market access of current payments and capital flows, which would be allowed in a freely convertible currency, and the free movement of capital relating to FDI would be allowed. But serious balance of payments difficulties and exchange rate or monetary policy difficulties would be provided for, while repatriation or liquidation of investments or the profits derived thereof would be guaranteed. Full liberalisation of portfolio capital would be left to consultations between the parties. Under this scenario, national treatment provisions would not be included; otherwise the agreement would contain many exemptions to safeguard West African countries. In addition, the agreement would not go beyond West African countries' General Agreement on Trade in Services (GATS) commitments. Dispute settlement procedures would not have investor-to-state provisions.

In the second scenario, though the investment promotion provisions might look like those in the first scenario, the West Africa-EU EPA might still develop into an agreement similar to the EU-Mexico or the EU-Chile free trade agreements (FTAs). It would include portfolio investment provisions, since in the CPA equity participation limited to non-controlling minority holdings was a condition of investment financing. In terms of market access conditions for current payments and capital flows, the agreement would include provision for the progressive elimination of restrictions on payments, but maintain a standstill on any new restrictions; allow exceptions for serious balance of payments difficulties and serious problems with the operation of monetary and or exchange rate policies; and contain many exemptions to the market access principle. West African countries, on their part, would reserve the right to maintain or introduce investment legislation that might restrict capital movements.

This scenario would explicitly integrate the GATS principles of market access, MFN and national treatment for services generally, and for financial services in particular. Thus all measures on the specific legal form of a financial services supplier would be forbidden. The national treatment principle would also be adopted for all non-service sectors as a follow-up to Article 15 of Annex II of the CPA, which requires parties not to discriminate between investors of the parties and third countries. Further, investment protection provisions would be determined under BITs with EU member states. Finally, the agreement would not have a separate dispute settlement mechanism for investment, but for financial services an arbitral panel could be established for the specific service.