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"A Ten Year Strategy for Increasing Capital Flows to Africa"

Thank you, Mr. Chairman, for conducting this important hearing on the African Growth and Opportunity Act (AGOA). Its timing is especially fortuitous -- just two weeks before President Bush's planned trip to Africa -- and affords Senators and other interested parties an opportunity to shape further the Administration's approach to accelerating growth and development in Africa.

I am testifying today in my capacity as Chairman of the Commission on Capital Flows to Africa. The Commission is a high-level, bipartisan and diverse group of experts who believe, as I do, that we can and must do more to increase private sector investment in Africa. On Monday, we released our final report: "A Ten Year Strategy for Increasing Capital Flows to Africa." It is a document of which I am proud, because it offers a comprehensive and bold strategy to accelerate Africa's growth and integration into the global economy. This goal, if achieved, will benefit not only millions of African men and women but also, in many respects, the people of the United States.

Mr. Chairman, allow me to begin by admitting that I came only belatedly to appreciate the potential to the United States, our citizens and investors, of increased trade and investment between the U.S. and Africa. As a veteran of the American financial community, I, like most of my colleagues, focused on other, seemingly more lucrative parts of the world. Like many in the investment community, my sense of Africa was that it was sufficiently plagued by war, famine, misrule and disease to render substantial foreign investment neither warranted nor advisable. My view changed in 1998 when, as Chairman of the Export Import Bank, I traveled to Africa following President Clinton's historic trip. What I learned was that Africa both needs and can effectively utilize private capital. I saw that smart capital, carefully invested, can yield high returns in Africa. As a consequence, I worked to expand the Ex-Im Bank's operations on the continent from 18 to 34 countries, triggering an increase in exports from $50 million in FY 1997 to $900 million in FY 2000.

The Commission on Capital Flows to Africa

I left government convinced that the public sector can and should do more to stimulate domestic and foreign investment in Africa. Convinced also that the private sector has an even greater role to play in this regard, I accepted the invitation to serve as Chairman of the Corporate Council on Africa (CCA). As Chairman, I helped to establish in September 2002 the Commission on Capital Flows to Africa, co-sponsored by CCA, the Institute for International Economics, the Council on Foreign Relations and the Joint Center for Political and Economic Studies. The Commission includes 28 leaders from North America, Asia, Europe and Africa with exceptional experience in business,

banking, policy research, government, academia, non-governmental organizations and international institutions.

We have deliberated and debated with passion and conviction, not just because we all envision a brighter future for Africa, but primarily because we believe that it is in the United States' interest to help secure sustainable development for Africa's people.

U.S. Interests

The U.S. has significant economic and national security interests in Africa, which underscore the rationale for and urgency of this Commission's recommendations. U.S. interests in Africa extend well beyond historical and cultural ties or the humanitarian and moral imperative to help lift the world's most under-developed region out of poverty and despair. Two broad areas of interest are worth highlighting: economic and security.

Mr. Chairman, our export-led growth depends substantially on the developing world, which is now the source of four out of every five of the world's new consumers. Soon one billion of them will live in Africa. In 2002, U.S. exports to Sub-Saharan Africa were 46 percent greater than those to the former Soviet republics (including Russia), 47 percent greater than to India, and nearly twice those to Eastern Europe. U.S. exports to South Africa alone were larger than U.S. sales to Russia, whose population is more than 3.5 times as large.[1] Yet, the U.S. share of the African market is small -- only 7.9 percent, suggesting significant growth *potential* for the U.S. in the years to come.

Our interests also derive from the fact that Africa supplies over 16 percent of our imported crude oil. It is estimated that within the next decade 20 percent will come from Africa.

Even more immediate are U.S. national security interests in Africa, which are also shared by our OECD and G-8 partners. Africa's fragile and impoverished states are among the weakest links in the U.S. war on terrorism. Without stability, economic opportunity and democratic progress, these states will grow increasingly vulnerable to exploitation by terrorist and criminal organizations and remain substantial security liabilities for the U.S. The American people, therefore, have a compelling national security interest in strengthening African economies and democratic institutions to increase African countries' will and capacity to be strong partners in the war on terrorism.

The Challenge

The challenge we face is daunting. The average African is poorer today than he or she was two decades ago, and the number of Africans living in poverty has increased steadily during the past twenty years.

[1] "U.S.-African Trade Profile," prepared by G. Feldman, Office of Africa, International Trade Administration, United States Department of Commerce, Washington, D.C., March 2003.

Yet, we must not allow Africa's poverty to obscure its potential. Since 1990, for example, 42 of 48 countries in Sub-Saharan Africa have held multi-party elections, and most Africans today have the right to choose their leaders at the ballot box. Though nowhere near adequate, there are recent preliminary indications that Africa may now be starting to see a slight recovery in foreign direct investment, a trend that some experts have attributed to significant and positive changes in the investment climate.

The challenge is underscored by compelling but contradictory facts. On the one hand, according to recent World Bank findings, investors reaped higher returns on investment in Sub-Saharan Africa last year than in any other part of the world. On the other, the World Economic Forum recently reported that the international investment attracted by all of Africa's 53 states is slightly less than the amount attracted by Singapore.

Despite the magnitude of the challenge, Africa's economic success and political stability are vitally important both for its own citizens and for the rest of the world. Its success will depend primarily on actions that Africans themselves take to establish strong economic, legal, and political institutions and policies. But it will also depend on supportive steps taken by the United States, the G-8, and other partners around the world.

There are many important components to a strategy for success, but undoubtedly a critical one is to encourage greater capital flows and investment in the region. Official development assistance (ODA) and World Bank lending will not be sufficient to facilitate Africa's integration into the global economy. Africa needs more <u>private</u> capital, more investments and more linkages to global markets to achieve its development goals. The Commission believes that an increase in capital flows to Africa is both critically important and eminently feasible. The Commission also urges that the United States take the lead among the G-8 and OECD countries in responding to this challenge.

A Ten Year Strategy

The Commission agreed upon "A Ten Year Strategy for Increasing Capital Flows to Africa," incorporating over 30 recommendations in the areas of trade liberalization, tax and investment policies, export credit, development assistance, privatization, debt relief, the New Partnership for African Development (NEPAD) and its focus on peer review and corporate governance, small and medium enterprises, and building Africa's human capital, particularly in finance. The Commission's report elaborates these recommendations in considerable detail and provides a summary of the analysis upon which they are premised.

Central to our endorsement of "A Ten Year Strategy" are three conclusions. First, this strategy must be built on a practical, committed and fair partnership between African governments and the private sector. African states eager to attract foreign investment must embark upon many of the reforms that investors, foreign and domestic, will prize: privatization, tax reform, legal and administrative transparency, and bureaucratic streamlining. In the process of attracting foreign investment, they must also take measures that improve the domestic environment more generally, and make it easier for

Africa's own entrepreneurs to succeed. If economic prosperity is to be achieved, African governments will have to accelerate the reform process. They will need to liberalize their economies, reduce their debt, and regenerate their health and education systems. If African governments fail to tackle these challenges, then no amount of foreign capital will suffice. It is on the basis of this belief that the Commission on Capital Flows to Africa strongly endorses NEPAD's vision of a **compact** predicated on the proposition that, as Africa undertakes critical political and economic reforms, the West must respond with substantial new public and private resources.

Second, it is our strong view that any comprehensive strategy to increase capital flows must extend beyond AGOA, however successful this initiative may be. It must also include increased trade liberalization, the provision of incentives to American investors, more effective use of the instruments provided by our trade agencies, the strategic deployment of foreign aid resources, further debt relief, and targeted efforts to enhance Africa's capacity to uphold its end of the bargain.

Third, we are steadfast in the view that the strategy we propose must be implemented over a period of at least ten years to give Africa the temporary advantage that has at other times been afforded to other regions and which will, we believe, allow Africa the opportunity to begin to catch up.

The Commission's Key Recommendations

For the purposes of this hearing, allow me to highlight our key recommendations, particularly those that pertain to the U.S. government:

1. African Growth and Opportunity Act

All of the Commissioners are strong supporters of AGOA but believe it is only an initial step in liberalizing trade between the United States and Africa. Now is the time to rectify AGOA's shortcomings and to build on its early success to help stimulate additional investment and economic growth in Africa.

Several limitations inhibit the ability of qualifying countries to benefit fully from the AGOA legislation. First, each country's eligibility must be reviewed annually, and second, the regime expires in 2008. Third, apparel imports remain subject to tariff rate quotas, or duty-free caps, as well as restrictions on the source of fabric. Finally, textiles and many other goods are excluded from AGOA benefits.

Recommendations:

- **First, the U.S. should extend AGOA benefits until 2018 as soon as possible, so that the current 2008 termination date does not act as a disincentive to investment.**

- **Second, ALL products coming from Africa should enter the U.S duty-free and quota-free. If this is not possible, then all TRQ limits on apparel imports**

should be lifted immediately to give Africa a head start on the global elimination of quotas in 2005. Additionally, the rules of origin permitting apparel exports from AGOA-eligible African countries made from textiles manufactured outside Africa or the U.S. should be extended for ten years to 2018.

- **Third, and as is the case for Canada and Mexico under the provisions of NAFTA, African countries should be exempted from U.S. safeguard actions that restrain imports in sensitive sectors.**

- **Fourth, country qualifications for AGOA should be presumed to last for ten years rather than being subjected to the current annual review process, which discourages investors. The President should retain authority to revoke a country's AGOA benefits under extraordinary circumstances.**

2. Agricultural Subsidies

Africa's ability to attract capital and increase trade is adversely affected by the domestic agricultural subsidies provided by the United States and the European Union. U.S. agricultural subsidies are a major impediment to African agricultural exports, which would otherwise be a significant source of economic growth on the continent. These subsidies also run counter to U.S. claims that it favors a more open and fair global trading system. The 2002 Farm Bill significantly increased U.S. farm subsidies, creating even greater non-market advantages to U.S. farmers and leading to significant declines in commodity prices, especially cotton, much to the detriment of African farmers. European farm subsidies do even more damage. If the U.S. is serious helping Africans to help themselves and creating opportunities for Africans to connect to global markets, then we must address this issue.

Recommendation: The U.S. should seek to accelerate the reduction or elimination of industrialized countries' agricultural subsidies, such as those contained in the U.S. Farm Bill and the EU's Common Agricultural Program, even in advance of the conclusion of the WTO's Doha Development Round. We also strongly encourage the U.S. to work to speed the successful conclusion of the Doha Round.

3. Free Trade Agreement

The original AGOA legislation enacted in 2000 envisioned an eventual free trade agreement (FTA) with Africa. The Commission applauds the Bush Administration for beginning negotiations for FTA with the five nations that comprise the Southern Africa Customs Union (SACU) but thinks the U.S. vision should be bolder and extend beyond the SACU countries. Other regional organizations such as COMESA, SADC and ECOWAS have also begun to create free trade areas to expand regional markets and facilitate the movement of goods, capital and services.

Recommendation: The Administration should set the goal of creating within ten years a U.S.-Africa Free Trade Area, building on ongoing African efforts to create

regional markets. The U.S. should also increase technical assistance to regional organizations to strengthen their capacity to negotiate and implement free trade agreements.

4. Tax Policy

To provide additional incentives to spur new U.S. investment in Africa, the Commission strongly favors bold but affordable changes to the U.S. tax code. Specifically, Congress should provide a time-limited exemption from U.S. taxation for bona fide FDI income earned by a registered subsidiary or branch of a U.S. company doing manufacturing or service business in Africa. This is not a new idea. Congress established a precedent with the Puerto Rico Tax Incentives Act of 1998. A similar incentive would increase the return on U.S. investments in Africa and lower the risk that many potential investors now perceive. Because many OECD countries do not tax their companies on foreign earnings, a zero tax on repatriated earnings would also make U.S. companies more competitive in Africa.

We can afford to do this at a modest cost. Total repatriated income derived by all U.S. firms in Africa in 2000 was $3 billion. As an outside estimate, U.S. tax revenue on the repatriated income would not exceed 10 percent of the $3 billion, or about $300 million annually. This amount would be considered a revenue loss.

For this measure to have its maximum impact, it would have to be taken in conjunction with tax reform in the recipient countries. By cutting corporate and withholding taxes and otherwise simplifying the tax system, African countries can attract more FDI and boost economic activity in a variety of manufacturing and service activities.

Recommendation: Congress should change to zero the tax on repatriated earnings on *new* investments by U.S. companies in Africa for a period of ten years.

5. Investment Policy

Commissioners agree there is much to be gained from making our official trade agencies more effective. Although Africa suffers from a lack of sufficient equity financing, for example, the Overseas Private Investment Corporation (OPIC) – the principal U.S. government instrument that supports non-extractive foreign direct investment in Africa - is prevented by statute from effectively providing much of this financing.

Originally established to promote development by insuring foreign direct investment against political risk, OPIC's authorizing legislation has become so restrictive that it does not – and currently can not – insure foreign direct investment in labor-intensive manufacturing and assembly projects of the kind that would be most beneficial to Africa. Under existing statute, OPIC is also forbidden from supporting "runaway investments" that result in the loss of a single job within the United States and is

restrained from providing insurance or financial guarantees to investments in "sensitive sectors" such as textiles, apparel or agribusiness.

Research shows that outward investment from the United States can significantly increase the flow of U.S. exports to the economy where the investment is located – and thus leads to a greater number of higher-paying, export-related jobs at home. Enabling OPIC to fulfill its role more effectively could therefore benefit both Africans and Americans.

Recommendation: OPIC should be permitted to support investment in all sectors in Africa for ten years, including sectors currently categorized as "sensitive," such as textiles and apparel, electronics, agribusiness and industrial products. OPIC should also be allowed to support investments that promise to provide net benefits for the U.S. economy instead of being prohibiting from supporting projects in which U.S. jobs are lost.

6. Export Credit Agencies

The Commission believes that parallel steps should be taken to enhance the role that our Export-Import Bank can play in tandem with other export credit agencies (ECAs). The availability of long-term debt capital is essential to the growth of the private sector. In recent years, the export credit agencies (ECAs) of OECD countries have collectively provided approximately $70 *billion* per year in long-term credit for developing countries to purchase goods and services from OECD members. However, less than 5 percent of this amount has gone to Africa. Under the current OECD arrangement, ECAs can finance local costs for African projects only up to 15% of the export value – a limit that constrains financing for many important projects, especially in infrastructure and other sectors where local costs are high. The Commission believes that there are straightforward changes that can and should be made in order to increase the involvement of export agencies in Africa by expanding the availability of long-term debt capital.

Recommendation: The U.S. should encourage the OECD to enable Export Credit Agencies to allow 20-year repayment terms (instead of the current ten years) for African projects and to raise the ceiling for local costs from 15 percent to 50 percent of the export value.

7. Development Assistance

The Commission welcomes the two new major aid programs proposed during the last year, the President's Emergency Plan for AIDS Relief and the Millennium Challenge Account (MCA), *provided* these initiatives are fully funded and are additive to existing programs and resources. While the Commissioners recognize the importance of investing aid dollars in the so-called "good performers," as the MCA proposes to do, we believe that there is also significant need to invest in the capacity of Africa's moderate performers and weak states to achieve political equilibrium and sustainable economic growth. The Commission concluded that, if indeed private sector growth is a central component of Africa's economic progress, the U.S. needs to invest more development assistance in

strengthening the conditions for that growth and in providing the tools that will allow the private sector to flourish.

Recommendation: More U.S. assistance should be invested in developing Africa's human capital (i.e. health and education), and a significant portion should be devoted to the establishment of long term, low-rate financing vehicles dedicated to small business in Africa as well as the provision of technical assistance to these small enterprises.

8. African Financial Fellowship Exchange Program

The Commission believes that it is in the interests of the private sector to help build Africa's capacity to attract and sustain investment. One of our most notable findings, particularly for those Commission members from the financial sector, is Africa's lack of exposure to and limited experience in managing the instruments of international finance, capital markets and corporate transactions. The State Department's aggressive effort to encourage African countries to obtain sovereign credit ratings, for example, is important to Africa's longer term economic future. Yet, there must also be a targeted and deliberate effort to build Africa's knowledge of and linkage to global finance.

Recommendation: **The U.S., in conjunction with other OECD governments and private sector entities, should create an African Financial Fellowship Exchange Program that would second professionals with finance, capital markets, corporate finance or economic policy experience to African countries to work in public and private institutions for a certain period of time. In exchange, each participating African country would commit two individuals for training for up to two years at qualified investment or commercial banks in the U.S. or other OECD countries.**

9. Debt Relief

Finally, the Commission concluded that, while constraints such as corruption and weak legal systems are more substantial in their impact on private sector capital flows to Africa, a country's debt profile and the effect that has on the creditworthiness of entities inside that country can influence the willingness of foreign sources of capital to extend loans. On the matter of how to address Africa's debt burden, however, the Commission was divided.

Members agree that the U.S. government should support an appropriate process to review the Heavily Indebted Poor Countries (HIPC) debt initiative and consider whether it is desirable to pursue proposals that go beyond HIPC. However, pointing to the fact that HIPC and the Enhanced HIPC program have not enabled African countries to achieve debt sustainability, some Commissioners argued for more specific measures, including capping debt service from all Sub-Saharan nations at 1 percent of GDP, provision of accelerated debt relief for countries emerging from conflict or autocracy, and the creation, by the U.S. and other G8 members, of a contingency facility that would make supplementary relief available in the event that a HIPC country encounters a severe debt deterioration due to events outside its control.

Conclusion

Clearly, the greatest responsibility for Africa's growth lies in Africa's hands. However, our Commission strongly believes that there is much that we can and should do. The U.S., G-8 and OECD governments can provide increased debt relief and more aggressive and directed program of foreign assistance. They can support NEPAD more actively and encourage the formation of substantially greater regional markets. Moreover, through the types of policy changes the Commission recommends, they can also help to spur greater inflows of private capital, a powerful catalyst for growth.

The Commission is well aware that increased private capital flows are but one of the many challenges that Africa faces. We are confident, however, that increased capital flows can contribute significantly to Africa's development, and that the U.S. government, together with the G-8 and OECD nations, could do much to stimulate and facilitate these flows. The budgetary costs to the U.S. of what we recommend would be modest, and more than offset as Africa becomes a stronger trading and investment partner. Moreover, these proposals would pay major dividends in terms of advancing U.S. humanitarian, foreign policy and national security interests.

The Commission on Capital Flows commends these proposals to Congress and urges that they be considered and adopted as quickly as possible. Major elements of the Ten Year Strategy will require new legislation: on trade, tax policy, OPIC, foreign assistance and debt relief. Mr. Chairman, we look forward to pursuing implementation of these initiatives with Congress under your leadership and that of this distinguished Committee.

Thank you.