

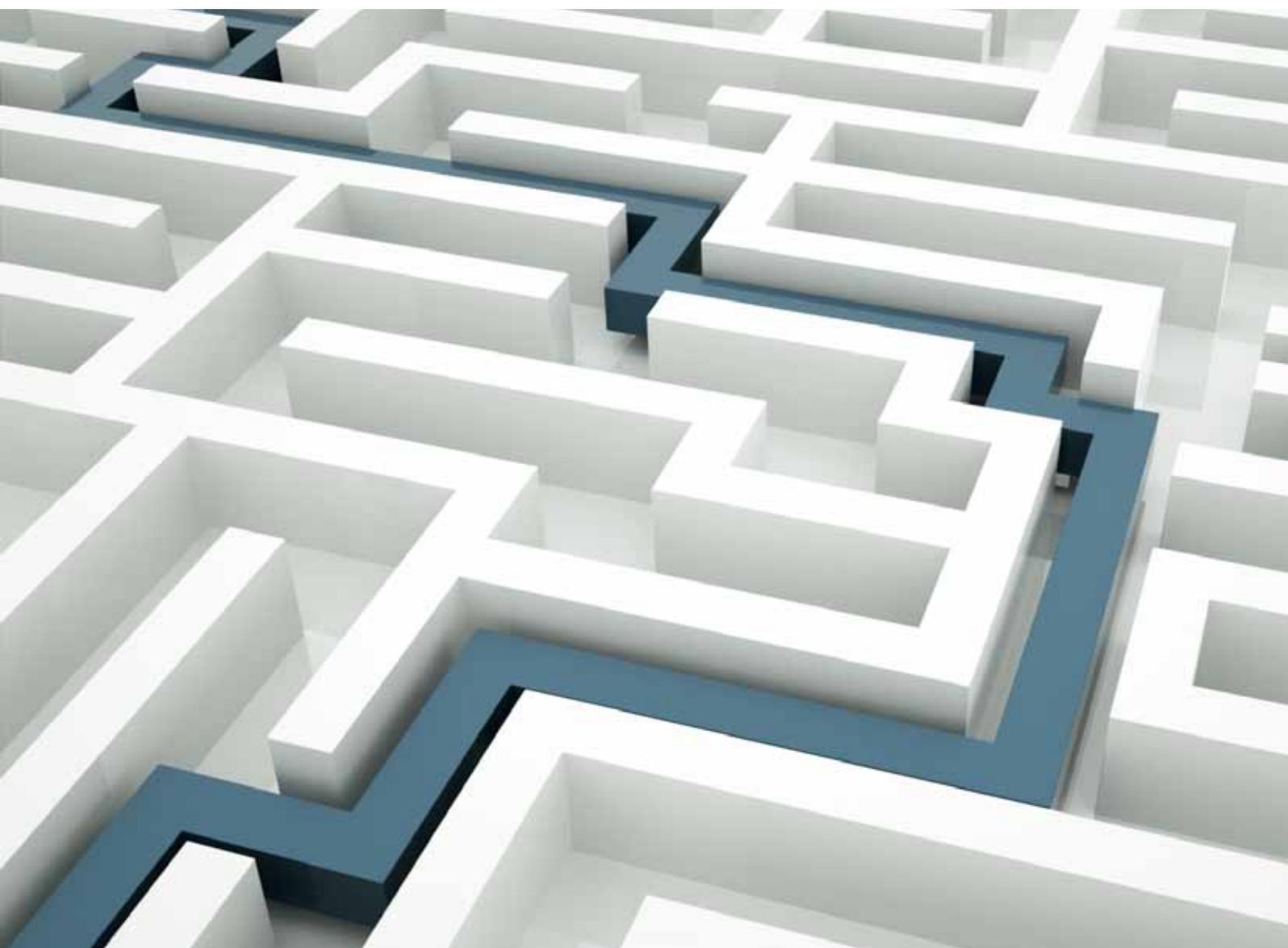


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## Trade Incentives Report CEO Briefing Report

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# a sweet incentive

A resources boom has foreign investors salivating to become a trading partner with Africa. *Africa investor* examines the potential for increasing the flow of trade through sweet incentive deals and trade agreements

**W**ith the IMF and World Bank anticipating average growth rates of more than 5% across sub-Saharan Africa in the years ahead, Africa's strategic importance to the world economy is rising fast. It is little wonder the region is being courted by traditional and emerging trading partners more assiduously than ever before.

African governments are rolling out a range of incentives to help lure them in. Providing access to vast coal deposits in Mozambique, iron ore in Guinea, and copper in the Democratic Republic of

Congo in exchange for infrastructure and revenue streams, is the most obvious strategy. But granting extensive land holdings in countries like Sudan, Tanzania and Zimbabwe in exchange for boosting agricultural output, and offering tax incentives in special economic zones from Nigeria to Zambia and Ghana to help kick-start Africa's dormant manufacturing potential, are also now being deployed.

Incentives to invest in such strategic sectors are also being augmented by a series of more finely-tuned tactical policies offering investors additional

fiscal concessions where they help boost job creation, such as in the service sectors in Ghana and Nigeria. Other examples include encouraging fledgling renewable energy sectors, such as South Africa and Kenya, and pledging not to impose windfall taxes on miners, as in the case of Zambia.

Africa is now attracting record levels of investment into its extractive sectors. The continent accounted for almost three-quarters of all global land deals during the past year, while the number of new export zones is rising rapidly. The resource-rich, but capital-poor, continent is using every

available strategy to ensure that its post-crisis recovery does not lose momentum, in an effort to ensure that high growth rates enjoyed across much of sub-Saharan Africa for most of the past decade remain the leitmotiv of African economies for years to come.

David Cowan, Citibank's Africa Economist, tells *Africa investor* that while eurozone troubles and slowing Asian growth are likely to constrain the African growth story in the short-term, "in the medium- to long-term there are reasons to be cautiously optimistic that sub-Saharan Africa can develop a range of new growth models that will help drive a more sustained pick-up in its growth story and deliver truly 'transformative growth.'"

"Some of these drivers such as agricultural growth tied in with high global food prices could be common to a large number of countries," Cowan says. "But others will be specific to individual countries, reflecting the different sizes and resource endowments of the many countries within sub-Saharan Africa," he adds.

## A better climate

African governments have traditionally made use of investment incentives in an effort to attract foreign investments, but their effectiveness has been the subject of intense debate. Some argue that there is little evidence such incentives are effective while others argue that investment incentives have contributed to the rapid economic growth of countries such as Mauritius (see box).

According to the World Bank, the investment climate is especially crucial for determining the effectiveness of incentives in attracting foreign direct investment (FDI). Although lowering effective tax rates helps boost FDI, the effect is eight times stronger for countries with good investment climates. This finding helps explain why incentives have encouraged investment in some countries yet failed in others.

In contrast to previous trade pacts, new trade agreements are being signed by increasingly assertive African governments offering short-term investment incentives, but seeking to extract longer-term economic benefits in exchange. Most

are also overhauling their business and investment climates to significantly improve their investor appeal.

The emerging powers of the G-20, particularly China, India and Brazil, were quick to grasp the continent's rising importance, seeing opportunities to invest, boost infrastructure, gain market share and win access to resources. China has set the pace in the race to develop African resources, infrastructure and markets, although other emerging markets like India and Brazil are now seeking to challenge that pre-eminence.

The importance of traditional trading partners in the European Union and the United States is gradually being diluted – although far from eliminated – by the surge in growth in Africa's trade with the

## Africa has become a pace-setter in business reforms making it easier to start a business and promote cross-border trade

global South. The IMF says that South-South trade now accounts for more than 50% of the Africa's exports, compared to just 25% in 1990, leaving the region's traditional trading partners trailing behind their emerging market rivals.

Sub-Saharan Africa's post-millennial growth spurt owes much to the wide ranging macro-economic reforms introduced across much of the continent over the past decade. Regional integration has also become an important strategy for sub-Saharan Africa to facilitate trade with traditional and new trading partners, as these economic communities move towards greater unification through reduced tariffs, alignment of regulatory policy, promotion of economic diversification and support of labour mobility. A central objective of regional integration is to establish economic partnerships that, according to the Botswana Ambassador to the United States, Tebelelo Sereste, would position sub-Saharan Africa as an "equal trading partner."

African governments are now seeking to build on these foundations by

## Mauritius: An economic success story

"Though a variety of explanations have been developed to explain Mauritius' growth performance, there is no doubt that the country's focus on international trade has been a critical element of that performance. Mauritius' preferential access to trading partners, particularly the European Union (EU), in the sugar, textile, and clothing sectors resulted in subsidies for the export sector and provided important foreign exchange for the economy. Preferential trading deals accounted a strong growth in Mauritius's total exports between the 1970s and the 1990s...Though import tariffs in Mauritius were kept high, they have never been high enough to interfere with the overall trade regime. Simultaneously, Mauritius pursued a very liberal investment regime and used incentives to attract foreign direct investment (FDI). Mauritius also offset the burdens on its exporters with tariff-free access for productive inputs and with tax incentive subsidies, and relaxed labour market regulations, in the export sector. Furthermore, it has used export processing zones (EPZs) to export key manufacturing goods, mostly apparel and textiles. Mauritius' overall trade and investment policy has been based on a managed embrace of globalisation and cultivation of market access."

Source: World Bank – Africa Success Stories Project

accelerating the integration of regional economic communities (RECs) such as the East Africa Community (EAC), the Common Market for East and Central Africa (COMESA), and the Southern African Development Community (SADAC), to help create bigger internal markets, and even unite all three RECs into a single continental-wide Free Trade Zone by 2017 – an ambitious economic goal announced by the African Union in early February.

IMF trade data indicates that exports of goods and services as a percentage

of GDP increased from 2004-10, among the four largest regional trade networks in sub-Saharan Africa: EAC (15%), SADC (11%), SACU (4%) and COMESA (9%). Imports of goods and services over the same period were: EAC (36%), SADC (10%), SACU (4%) and COMESA (18%).

They are also courting new investors by creating special economic zones to promote import substitution to foster their own manufacturing bases, as in the case of Nigeria, Zambia and now South Africa. They are offering attractive tax and investment incentives to revive or promote their extractive and other productive sectors such as those implemented in Ghana, Tanzania and now Nigeria. But they are also overhauling their business climates to make doing business more attractive for foreign and domestic investors, especially in fast growing service sectors,

as in the case of countries from Rwanda to Mozambique, Uganda to Botswana, and Kenya to Cameroon.

Africa has become a pace-setter in business reforms making it easier to start a business and promote cross-border trade, two areas where the continent has traditionally lagged behind all other geographies. Sub-Saharan Africa is now the second most active region in the world after Eastern Europe for introducing business start-up reforms such as reduced capital requirements and one-stop shops for business licensing and registration. Rwanda, Zambia, Cameroon, Ghana and Mozambique have since leapt into the world's top ten performers for cutting business red tape.

### A model agreement?

Recognising the dramatic gains made by Africa's emerging trading partners,

Africa's traditional trading partners in the US and EU are increasing their efforts to build "cooperative trade agreements," although both have been the target of African criticism. In response to the improving status of sub-Saharan African countries as trade partners, Washington recently renewed the eligibility for all 40 countries currently receiving benefits under the African Growth and Opportunity Act (AGOA).

Last year, African exports to the US reached US \$64 billion, more than \$44bn of which entered the US duty free. Although non-oil exports from automobiles to apparel, and from footwear to value-added products, have seen significant growth, oil still accounts for the bulk of US imports. Florie Liser, the Assistant US Trade Representative for Africa, says that the major priority of AGOA is "helping our African partners to add value to their own commodities to attract the investment that comes with that, and put them on the same path that has contributed to the economic development of emerging economies in Latin America and Asia."

But it is a slow process. Of the 6,000 or so products covered by AGOA, Africa has

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been able to take advantage of around 60. Africa does not yet have the productive capacity to take full advantage of AGOA, although prospects for doing so should improve as Africa's productive base begins to expand.

The EU continues to advance the case for Economic Partnership Agreements (EPAs), which offer reciprocal trade agreements to replace existing non-reciprocal deals granting African countries preferential access to EU

## Southern African trade agreements

### Free Trade Agreement between the EFTA States and the SACU States

**Objective:** To provide a free trade area between the Southern African Customs Union (SACU) and the members of the European Free Trade Association (EFTA) in conformity with the General Agreement on Tariffs and Trade.

**Applicability:** Products falling within Chapters 25-98 of the Harmonized System, processed agricultural products and fish and other marine products.

**Benefit:** EFTA to abolish all customs duties on imports from SACU. SACU to gradually reduce customs duties on imports originating in the EFTA.

### Trade Development and Co-operation Agreement (TDCA)

**Objective:** To provide a Free Trade Area (FTA) between South Africa and the 27-member European Union (EU) by the year 2012.

**Applicability:** Exports of South African origin and imports from the EU will gain preferential markets access to each other's market.

**Benefit:** The customs duty on 95% of South African exports and EU imports will be phased down to free of duty by the year 2012.

### Southern African Development Community (SADC) Free Trade Area

**Objective:** To provide a FTA between South Africa and the 15-member SADC.

**Applicability:** All exports of South African origin and imports from the SADC will gain preferential markets access to each other's market.

**Benefit:** The customs duty on 95% of South African exports and SADC imports will be phased down to free of duty.

markets. Only around ten of the 47 sub-Saharan African countries have signed EPAs, with many of the rest remaining hostile towards the deals.

Charles Soludu, the former Governor of the Nigerian Central Bank and Presidential Economic Advisor, is one of many African critics who accuse the EU of seeking to use EPAs to prize open African markets to its exports, effectively preventing Africa “from using the same kinds of policies that all industrialised countries once employed to build their own economies.” Such protectionist policies are still in place with the EU’s annual \$75bn Common Agricultural Policy subsidy, making it virtually impossible for African farmers to access EU markets.

## Emerging partners

The 2006 Beijing Forum on China-Africa Cooperation confirmed China’s agenda for state-driven capitalism and private entrepreneurship, offering a model of economic partnership which combines trade and investment with Africa on the basis of political non-interference. China became Africa’s leading trading partner in 2009, with two-way trade exceeding \$114bn in 2010; a tenfold increase over the \$10bn recorded in 2000.

China’s recent foray into special economic zones in countries such as Nigeria and Zambia offers the prospect of promoting manufacturing in Africa, based on China’s success in using their own zones as a pathway to export promotion and poverty alleviation. However, it raises concerns about the potential for economic exploitation by crowding out African investment in the new zones, and by excessive reliance on Chinese labour.

India, whose bilateral trade with Africa increased from \$3bn in 2000 to \$32bn in 2011, and Brazil, whose bilateral trade with Africa increased from virtually nothing in 2000 to nearly \$21bn in 2010, are both seeking to capitalise on Chinese weaknesses, portraying themselves as more sympathetic trading partners than their Chinese rivals, although just as keen to gain access to African resources, markets and rising infrastructure

spending.

Offering incentives is therefore not without its problems. Extending tax incentives can place extreme pressure on the existing tax base, and incentive schemes for new investments can run the risk of ignoring existing investments. In addition, obtaining incentives can raise costs and incur time delays for potential investments. Extensive monitoring, control mechanisms and policymaking

should therefore be prioritised, as should strong criteria for those eligible.

For Africa, the demise of the developed economies’ virtual stranglehold on the continent’s development prospects, and the rise of a plethora of new development partners, gives the continent a range of economic partners unmatched in its history. It offers Africa a unique development opportunity which must not be squandered. 

## Nigerian incentives, benefits and guarantees

### (i) Incentives for special investment

For the purpose of promoting identified strategic or major investment, in consultation with appropriate government agencies, Nigeria will negotiate specific incentive packages for the promotion of investment.

### (ii) Double taxation agreements

Double taxation agreements have been formed by Nigeria with a number of countries. These agreements are entered into with a view to affording relief from double taxation in relation to taxes imposed on profit taxable in Nigeria and any taxes of similar character imposed by the law of the country concerned.

### (iii) Investment Promotion and Protection Agreement (IPPA)

As part of additional effort to foster foreign investors’ confidence in the Nigerian economy, the government enters into bilateral investment promotion and protection agreements (IPPAs) with countries that do business with Nigeria. The IPPA helps to guarantee the safety of the investment of the contracting parties in the event of war, revolution, expropriation or nationalisation. It also guarantees investors the transfer of interests, dividends, profits and other incomes, as well as compensation for dispossession or loss.

### (iv) Liberalisation of ownership structure

The government has liberalised the ownerships structure of business in Nigeria. The implication of this is that foreigners can now own 100% shares in any company as opposed to the earlier arrangement of 60%40% in favour of Nigerians.

### (v) Repatriation of profit

Foreign investors are free to repatriate their profits and dividends net of taxes through an authorised dealer in freely convertible currency.

### (vi) Guarantees against expropriation

The Nigerian Investment Promotion Commission Act guarantees that no enterprise shall be nationalised or expropriated by any government in Nigeria



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**For more information please contact,**  
Catherine Wright: [cwright@africaninvestor.com](mailto:cwright@africaninvestor.com)

**Africa investor**

93 Protea Road, Chislehurst, Sandton, 2196  
P.O. Box 41922, Craighall, 2024

Tel: +27 11 783 2431

Fax: +27 11 783 2430

Website: [www.africaninvestor.com](http://www.africaninvestor.com)

Television site: [www.africaninvestor.tv](http://www.africaninvestor.tv)

News wire site: [www.ainewswire.com](http://www.ainewswire.com)