

Encouraging Cross-Border Investment in CAF Economies

**Remarks by Ngozi Okonjo-Iweala, Managing Director, The World Bank
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What I'm about to say might shock you – but it's all true.

- **The annual global cost of conflict is estimated to be about \$100 billion.**
- **Fragility and conflict affect 45 countries. That's a quarter of the world's states.**
- **34 of those countries are among the world's poorest.**
- **An estimated one billion people live in fragile and conflict-affected states. That's one in seven of us on this planet.**

If you consider these statistics, there is no doubt that conflict-affected and fragile economies face huge development challenges. In many countries, basic infrastructure such as roads, communications networks, and trade links has been destroyed. These countries suffer because their people have been seriously impacted. Institutions are weak, while dysfunctional financial, government, and legal structures further complicate the recovery effort.

I know it does sound a daunting task to turn this around. But, as Winston Churchill said: “A pessimist sees the difficulty in every opportunity; an optimist sees the opportunity in every difficulty.”

I'm here today to ask you to be among the optimists—to remind you that where there are risks—there are rewards. I want to encourage you to seek the opportunities amid the challenges. Why is it so important? The answer is simple: foreign direct investment is vital to development. We know that foreign direct investment has a tremendous impact on re-building conflict-affected countries while

also encouraging spin-off investment. We have research that strongly shows that such investment can help make the difference between a country relapsing into more conflict or emerging from fragility on the road to recovery.

But we have also seen that only a handful of countries absorb most of that investment. The so-called BRICs – Brazil, Russia, India and China - absorbed about half of all foreign direct investment received by developing countries last year. In contrast, the poorest countries received a mere 3 percent of the direct investment pie. And countries that have suffered from intense political violence – war, terrorism, civil disturbance – or are fragile and more susceptible to political violence, accounted for some 10 percent. In other words, in 2009 at most, \$35 billion of the \$354 billion in foreign direct investment reached the countries that needed it the most.

Why are we so concerned? Because we know that development aid alone cannot make the difference. Foreign direct investment plays an important role in helping conflict-affected economies get off the ground. Countries that have just come through a war usually have levels of unemployment which are off the charts— in the order of 65-70 percent. It's not surprising income levels are low. For example, real per capita income in Lebanon in 1990 was about one-third its level in 1975, while in Bosnia and Herzegovina, post-war incomes were about a quarter of what they were before the war. The employment created by foreign direct investment therefore is absolutely critical.

Moreover, foreign direct investment helps build much – needed infrastructure and encourages technology transfers. In this way, the private sector can help relieve the burden on governments by taking on these tasks so governments can utilize their limited funds on meeting the acute needs of their people.

Risk and Reward

Therefore, and this is no surprise, we need the private sector, you, to partner with us. This is not charity. Make no mistake, profitable investment opportunities do exist in these countries. They are a diverse group, which includes several economies rich in natural resources. If investors are willing to take risks, they will reap the rewards. Let me give you just a few examples where intrepid investors have gone into conflict-affected and fragile economies—and have fared well:

- Let's look at Afghanistan. The MTN Group, a South African-based multinational telecommunications company with operations in Africa, Asia, and the Middle East, recently entered the market. By 2009, MTN was first in terms of market share; had launched five new customer service points in five major cities; and had significantly improved its reach to more than one million customers. The investment has paid off in returns for the investor—and importantly has achieved development impact for the country. Residents and businesses now have a range of affordable and reliable telecommunications services, including wireless cell phone, Internet and satellite services, as well as public pay phones.
- In Bosnia and Herzegovina the war brought a complete collapse of the local banks. They fell like dominoes, one after the other, leading to a total loss of people's life savings and widespread mistrust. However, once the war ended foreign investments in banking, financial services, and manufacturing sectors, among others, helped send the signal the country was a viable place to do business, while at the same time enabling the country's economic reconstruction. For example Coca-Cola's investment for the rehabilitation and modernization of a bottling facility created jobs for people in the factory as well as related areas of construction, supply and transport, sales, and marketing.
- Djibouti is another case in point. The construction of the new state-of-the-art container terminal operated by DP World of Dubai has been transformational. It has helped propel the resource-poor, but strategically located country to begin to emerge as a key trade gateway for the member nations of the Common Market for Eastern and Southern Africa. Indeed, since the first ship entered the new port in December, 2008, the project has been delivering impressive results. So

much so, that DPW is using the Doraleh Container Terminal as a facility for best practice training in port management, including offloading, customs clearance, and security related issues. Not only is the container terminal setting technical and efficiency standards for other port operations, but it is located in one of the world's poorest countries and serving as the backbone for the nation's economy.

These are just a few examples. But they do powerfully illustrate that despite the presence of political violence and fragility in many parts of the world, opportunities do exist. There are many more examples of countries, like Mozambique for example, which have emerged out of conflict and were on the path to recovery with the help of foreign investment. These investments do more than send a powerful signal to others that the country is suitable as an investment destination. It also serves to reestablish valuable links to international markets and provides an impetus for improving the rules, regulations, and procedures to help improve investment climates in post-conflict countries. We are seeing this now in Sierra Leone and Liberia, among others.

The Post-Crisis World

We know today times are difficult everywhere. The world is just now emerging from a severe recession only to face new challenges: the risk of anemic growth coupled with yawning fiscal deficits and high unemployment in the industrialized world. The recovery from the financial crisis is fragile and uneven. There are also other risks on the horizon – such as high volatility in food prices.

One particular bright spot has been the growth in developing countries. That is not to say the crisis did not impact them – far from it. Growth rates slowed down to a mere 1.7 percent and international capital flows fell from their peak of \$1.2 trillion in 2007 to \$554 billion in 2009. And last year's foreign direct investment of \$354 billion that I mentioned before was down by 40 percent from its peak of \$587

billion in 2008. However, developing economies are growing at a faster pace than developed economies— nearly twice the rate of industrialized countries over the next couple of years.

On the trade front, developing countries' demand for imports is rising twice as fast as that in industrialized countries. And in terms of foreign direct investment, their share of global flows has risen from less than a quarter at the beginning of the decade to 37 percent this year.

Just look at sub-Saharan Africa, for example.

- The global economic crisis led to a drop in the growth rate to 1 percent in 2009; but the region is expected to rebound to 3.8 percent and then 4.5 percent in 2010 and 2011, faster than Latin America, Europe, and Central Asia.
- This resilience is not an accident but underpinned by what has evolved over the past 15 years into a deep commitment to reform, and political and economic stability. More of the region's countries are now regarded as frontier emerging markets, including Botswana, Cape Verde, Ghana, Kenya, Mauritius, Mozambique, Namibia, Nigeria, Seychelles, South Africa, Tanzania, Uganda, and Zambia.
- They say the litmus test of commitment to reform is when times are difficult. Two-thirds of African economies implemented reforms during the global financial crisis to make it easier for investors to operate. The World Bank Group tracks countries' regulatory conduciveness in its annual *Doing Business* report. In 2008–09 alone, Rwanda completed seven *Doing Business*-related reforms, Mauritius six, and Burkina Faso and Sierra Leone five each. Indeed, Rwanda's and Liberia's measures were so significant that they both received "top reformer" status. : Rwanda was the number-one reformer worldwide in *Doing Business* last year, and Liberia was number ten. This year's list of the 10 most-improved economies in improving business regulations includes three in Sub-Saharan Africa.

Looking Forward

So what does this mean for you? Many of you are looking for new markets and new investment opportunities in the developing world. For the report we're launching today, MIGA surveyed large corporations headquartered all over the world and 40 percent of them expressed their intention to increase their investments in developing destinations over the next twelve months. The picture is even brighter for the next three years: 63 percent of these corporations intend to increase their investments in the developing world.

I'm not naïve. I know, as you do, that it's risky and that challenges remain. MIGA's report outlines that concerns over unpredictable changes in regulations, or even the absence of a regulatory framework in particular sectors, rank high among the risks facing foreign investors. This is more so in conflict-affected countries that lack well-functioning institutions, credible governance mechanisms or suffer from corruption. This is not surprising. Sudden and unpredictable changes in the "rules of the game" -- increases in taxes and royalty payments, or forced contract renegotiations -- vex investors. But what *is* perhaps surprising is that foreign investors in conflict-affected countries are more concerned about adverse regulatory changes and other forms of adverse government interventions, such as expropriation, rather than political violence. This finding of MIGA's report underscores the importance of regulatory environments which are conducive to foreign and domestic investment. . Therefore, governments too have a crucial role to play in ensuring a solid regulatory framework is in place to prevent these things from happening.

The World Bank Group, through its *Doing Business* project, as well as its *Investing Across Borders* report, which focuses specifically on foreign direct investment regulations around the world, takes this issue very seriously. We offer advisory services to countries in need of guidance. We have seen vast improvements in many countries, which were once among the ranks of the conflict-affected and fragile: including those I mentioned earlier: Rwanda, Liberia, and Sierra Leone.

As a development institution, we in the World Bank Group work with governments, who are our shareholders and our clients. But we can also support your private sector efforts to bring much-needed investment into developing countries around the world. MIGA's offering of political risk insurance to the private sector is a very salient example of this.

Handling the Risk

MIGA's report interestingly observes that political risk trumps economic factors, such as the quality of infrastructure, the size of domestic market and the availability of skills, which one might think would play a bigger role in project location decisions. These findings are consistent with the forthcoming World Development Report on conflict, security and development.

The question then becomes how to handle that risk?

Experience shows with a better understanding of the broader context of conflict and fragility, companies can design their operations to reduce unintended impacts and support societal forces that contribute to stability and peace. Most multinational companies know it is in their best interest to be good corporate citizens. They use various ways to survive in uncertain investment environments. For example, they often use subcontracting arrangements, work closely with surrounding communities to generate jobs and spread profits locally, and donate goods and services to help meet local basic needs.

Managing political risks, along with traditional economic and financial risks, is increasingly becoming a normal part of the corporate decision-making cycle for companies investing abroad.

Yet, political risk insurance remains an underutilized, but important, tool. MIGA's report notes only a quarter of foreign investors use political risk insurance when investing in developing countries. Only a

small proportion -- an estimated 10 percent -- of foreign direct investment is actually insured. We can and should do more to raise awareness about this tool to give you the knowledge and comfort you need to be able to make your investment decisions. MIGA, through this report, aims to do precisely that- raise awareness of the product and its advantages in mitigating political risks, especially for investors challenged by the accentuated circumstances of conflict-affected and fragile economies.

Conclusion

There is no doubt there are serious challenges for conflict-affected and fragile countries, as they seek to stabilize and integrate into the global economy. Foreign direct investment is one of several channels through which this can be achieved. The World Bank Group also stands by their side to help them build strong and credible institutions.

Equally important, we need to get back on track with more growth and jobs. We are helping on that front. Since the global economic crisis began, the World Bank Group has committed more than \$140 billion to its member countries and disbursed a record \$81 billion – including \$21 billion to the world’s 79 poorest countries. At the height of the crisis, from July 2008 through March 2009, the Bank committed \$965 million to fragile and post-conflict countries.

Through lending as well as private sector finance and support through political risk insurance, the World Bank Group is doing what it can to reduce poverty and improve people’s lives.

For today, we encourage you and your companies to consider new frontiers. We know for those companies willing to invest in conflict affected and fragile countries, the rewards can be well worth it. As Churchill said “difficulties mastered are opportunities won”. Thank you.