Is the US Ready to Compete in Africa?
Recommendations for Modernizing US Economic Policy Tools

Testimony before the Senate Foreign Relations Committee
Subcommittee on Africa and Global Health Policy

Ben Leo
Senior Fellow and Director, Rethinking US Development Policy Initiative
Center for Global Development

March 19, 2015

Thank you, Chairman Flake, Ranking Member Markey, and other members of the Subcommittee. I appreciate the opportunity to appear before you today to discuss the potential for greater US trade and investment with Sub-Saharan Africa. This hearing sends an important message about Congress' focus on expanding private sector-based development approaches in this increasingly strategic region. It is particularly well timed following the historic US-Africa Leaders Summit last August and several issues that the 114th Congress will be considering this year, including the African Growth and Opportunity Act and the Energize/Electrify Africa Act.

Within this broader context, my testimony will briefly highlight some of the most obvious gaps in our current approach, along with key opportunities and challenges. I also outline three specific policy recommendations for your consideration, including:

(1) **Congress should urge the Administration to pursue legally binding Bilateral Investment Treaties (BITs)**. Such action will promote greater US investment flows to the continent while also positioning US investors on equal footing with European, Chinese, and other investors who benefit from BIT protections.

(2) **Congress should modernize US development finance tools by creating a modern US Development Finance Corporation (USDFC).** This budget-neutral reform would ensure that US policy tools better respond to developing countries' priorities and emphasize private sector-based development models. More modest reforms to the Overseas Private Investment Corporation would be beneficial even if Congress does not move forward with a USDFC.

(3) **Congress should pass Energize/Electrify Africa legislation that promotes US investment in the power sector and improves economic opportunities along with health and education outcomes.** Such action would send a strong signal to African leaders, businesses, and people that the United States is a strategic and long-term partner.

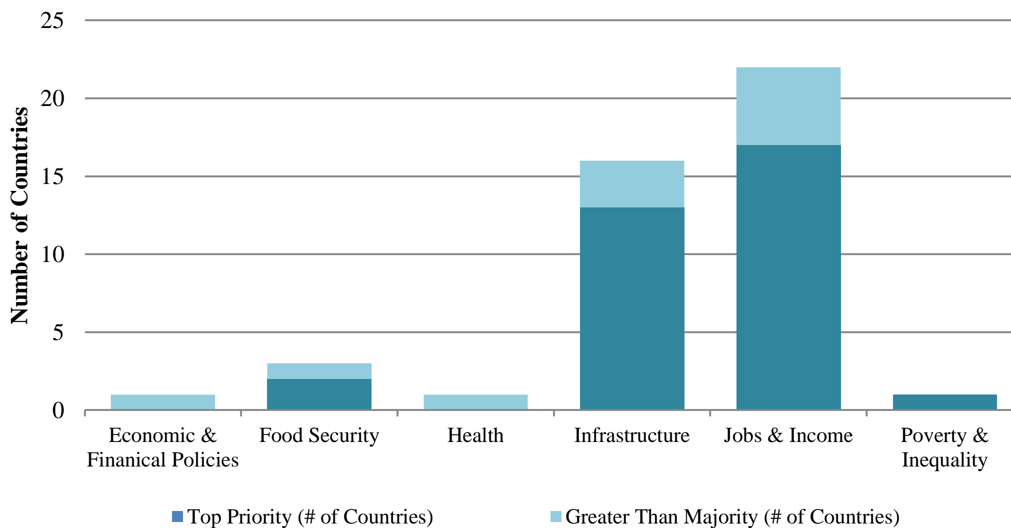
THE NEW US-AFRICA NARRATIVE – RHETORIC AND POLICY REALITY

Last August, the US government turned an important page in its relationship with Sub-Saharan Africa. President Obama and his administration declared that they were listening to the priorities of African governments, businesses, and people. The official US-Africa Leaders Summit agenda naturally covered a broad spectrum of issues. However, the central narrative was delivered with succinct clarity. America finally has awoken to the growing economic opportunity and importance of Sub-Saharan Africa. While the main Summit takeaways were largely rhetorical, this shift in mindset should not be underestimated.

Overall, Africa projects a promising future despite global and localized headwinds. Regional GDP growth has averaged 5 percent annually since 2000, exceeding levels in Latin America, Central Asia, and the Middle East. Foreign direct investment has increased nearly six-fold, and is now rapidly expanding into consumer and service sectors. Macroeconomic management, such as controlling inflation, has vastly improved compared to the 1980s and the 1990s. Even with falling commodity prices, growth is projected to remain strong over the near- and medium-term.

Above all else, most Africans desire an American partner that is focused on helping to deliver economic opportunities, primarily through greater trade and private investment flows. Roughly 70 percent of surveyed Africans cite economic issues – such as jobs and infrastructure – as their most pressing priorities.[i] These priorities transcend geographic, gender, and age divides. These views, expressed by ordinary Africans given a voice through representative surveys, contrast sharply with how most Americans view the continent. After decades of depressing media coverage, we might expect Africans to overwhelmingly prioritize humanitarian needs, such as basic healthcare, education, and food security. That is not the picture emerging from much of Africa. The US-Africa Leaders Summit made it clear that the US government has begun to internalize these shifting dynamics.

Figure 1 – Jobs, Income, and Infrastructure Dominate African Concerns



Source: Afrobarometer

Despite immense opportunities, many African economies remain constrained by poor business climates, small market size, and collusive political economy dynamics. Among the greatest barriers to growth are unreliable and costly electricity; high transport costs; inadequate access to finance; and burdensome regulations and corruption. The responsibility for confronting these challenges rests squarely with African governments, and their citizens who must hold them accountable. Yet, the US government can play a strategic supporting role in helping to address them.

While the Leaders Summit suggests that US officials have started to internalize the Africa Rising reality, even amidst regional threats and challenges, actual Obama Administration policy and ongoing messaging has been much slower to adapt. Judged solely by White House and State Department press statements and social media feeds, casual observers might believe that America's top *continent-wide* priorities are combatting wildlife trafficking and LGBT discrimination. The question is not whether these kinds of issues should be raised and discussed with America's partners in the region. Instead, the question is whether they should dominate the post-Summit rhetoric emanating from Washington and its senior government officials, when these issues do not appear anywhere near the top of African nations' priorities, whether Americans like it or not. Particularly in light of the proposed new framework for US-Africa relations, which revolves around a private sector-based partnership that is supported and enabled by respective governments.

Going forward, Congress should push the Obama Administration to deepen and accelerate its emerging US-Africa narrative through several strategic steps. This includes: (1) pressuring the Administration to launch an ambitious round of BIT negotiations with African nations; (2) overhauling US development finance tools; and (3) passing landmark legislation focused on African energy poverty issues. Africa has always been a region that attracts broad bipartisan support. There is both an opportunity, and an urgent need, to advance this agenda. If we fail to act and continue to build real momentum after the Leaders Summit, then America's influence and relevance will be eroded in an increasingly multi-polar world. There is no question that other actors, such as China and other emerging nations, will fill America's leadership void, and capitalize on their closer alignment with the continent's agenda.

RECOMMENDATION 1: UTILIZE BILATERAL INVESTMENT TREATIES AS A LOW-COST POLICY TOOL

Bilateral investment treaties have long been low-cost policy tools for promoting investment, both among developed and developing countries. From a development and commercial policy perspective, BITs can encourage investment by providing foreign investors with core protections against political risk and uncertain business environments, such as expropriation, discriminatory treatment, or weak and partial legal systems. According to UNCTAD, there are now over 3,200 investment agreements globally, including almost 300 involving African nations. In addition, many African governments are negotiating BITs with their neighbors, such as Mauritius, which has signed or ratified agreements with 17 African countries since 2000.

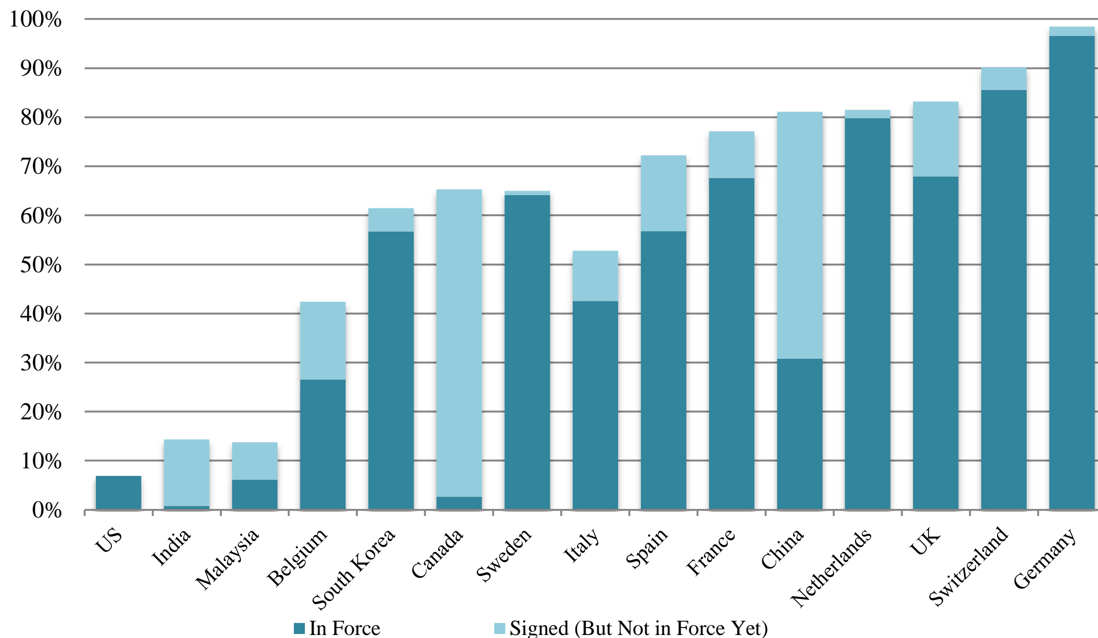
Many econometric studies find that BITs have a positive and significant impact on

promoting foreign direct investment (FDI) flows to developing countries.[ii] While BITs clearly are not a silver bullet, the potential return on US government action is very high. This is due to their low-cost nature, which only includes salaries and travel budgets for US government negotiators. BITs pose no costs to US taxpayers beyond these modest expenses.

Despite these benefits, the United States is lagging far behind European, Asian, and other emerging market players when it comes to negotiating BITs with African countries. Currently, the United States has only six agreements in place, which include: Cameroon (1989), the Democratic Republic of Congo (1989), Republic of Congo (1994), Mozambique (2005), Rwanda (2012), and Senegal (1990). Collectively, these treaties cover a mere 7 percent of regional GDP. Even if the United States completed hoped for agreements with Mauritius and the East African Community, which have been under consideration for several years, regional coverage rates would remain extremely low at roughly 15 percent. To date, the Obama Administration has not signed a single investment agreement anywhere in the world.

Other capital-exporting countries, such as China and Canada, demonstrate that African governments are ready and willing to sign investment promotion agreements. China has signed investment treaties with 24 African countries, including 15 out of the largest 20 regional economies. Once all of these agreements are ratified, China will have legally binding agreements covering almost 80 percent of regional GDP. In addition, Canada has signed BITs with eight African countries in the last few years. This includes the region's economic powerhouse, Nigeria, whose roughly $600 billion economy is larger than Malaysia and Vietnam combined.[iii] In addition, Canada has several more negotiations underway, such as with Ghana and Kenya. Canada's rapid progress has been driven by Prime Minister Harper's strong commitment to advance BITs as a core commercial and development policy tool. If the Obama Administration demonstrated a similar level of political support and ambition, whether on its own or pushed by Congress, the United States could achieve similar progress.

Figure 2 – US BIT Coverage Lags Far Behind Other Investing Nations --
% of Sub-Saharan Africa's GDP Covered by Investment Treaties



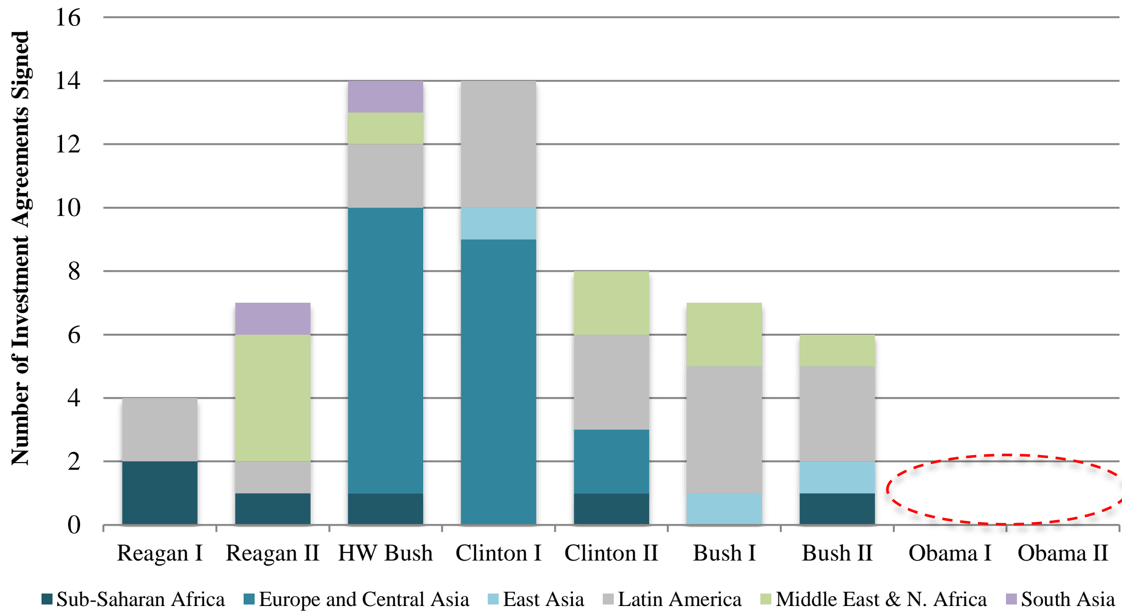
Source: UNCTAD, IMF World Economic Outlook database

The US government should address the new Model BIT's complexity, which could limit our ability to conclude negotiations with many African countries. In 2012, the United States unveiled a new template agreement, which sought to address past concerns raised by labor unions, environmental groups, other NGOs, as well as some developing countries that wish to retain more public policy sovereignty and flexibility. As a result, the 42-page template now affords more government discretion than in the past, which is one reason it is so complex. For example, it exempts government actions (except "in rare circumstances") to protect health, labor, and consumer safety from investors' protections against expropriation. These modifications have broadened US political support for this policy tool. Yet, the US government will need to consider ways of addressing the practical challenges posed by an increasingly complex template agreement. There are two concrete options for doing so. First, USAID could provide targeted bilateral technical assistance for countries engaging in BIT negotiations, as it did with the US-Central American Free Trade Agreement (US-CAFTA). Second, the US government could provide modest financial contributions to multilateral facilities, such as the Africa Legal Support Facility, which is housed at the African Development Bank.

Going forward, Congress should pressure the Administration to *stop* investing in ineffectual Trade and Investment Framework Agreements (TIFAs) and *start* investing in BIT negotiations. Over the last decade, USTR has focused almost solely on pursuing TIFAs in Sub-Saharan Africa, which provide no binding protections for US investors and do not advance a real reform agenda. This misplaced and non-strategic effort has distracted limited US government attention from pursuing real negotiations with African nations. Put differently, while China, Canada, and other nations have been signing countless legally binding treaties, the United States has been signing TIFAs that provide no tangible benefit to US investors and companies. It is time to stop allocating

scarce resources to these inconsequential talk shops and move toward pursuing real agreements that catalyze much needed (and wanted) investment flows.

Figure 3 – The Obama Administration Has Failed to Sign Any Investment Agreements Despite Historical Bipartisan Progress



RECOMMENDATION 2: REFORM AND UNLEASH US DEVELOPMENT FINANCE TOOLS

There is an urgent need to implement targeted reforms that would improve the effectiveness, impact, and scale of US development finance institutions. In many ways, the future of development policy lies in development finance. This reflects a number of new dynamics, including: growing citizen and business demand, entry of new emerging market actors, a shift towards private sector-oriented development models, and the declining importance of foreign aid. As noted previously, foreign government partners are increasingly focused on attracting private investment, especially in infrastructure and productive sectors. Nearly every national development strategy includes a strong emphasis on attracting investment for physical infrastructure (e.g., electricity and transport) and labor-intensive sectors such as agriculture and services. Currently, most US aid programs are not designed, structured, or equipped to address these shifting needs.

The primary US development finance institution, the Overseas Private Investment Corporation (OPIC), is a highly constrained and under-utilized tool. OPIC's mission is to promote US development, commercial, and foreign policy objectives through private investment abroad. It is a remarkably effective tool for US policy given its constraints. It provides US investors in developing countries with debt financing, loan guarantees, political risk insurance, and support for private-equity investment funds when private actors cannot. It operates on a self-sustaining basis and has provided positive net transfers to the US Treasury for nearly 40 consecutive years. Since its inception, OPIC has helped

mobilize more than $200 billion of US investment through more than 4,000 development-related projects. However, a modernized, scaled-up OPIC is desperately needed as US development policy moves beyond aid.

With few exceptions, OPIC has not evolved since its establishment in 1971. This means that OPIC has been unable to adapt its model to changing market-based demands and/or adequately address some of its past critiques (see details below). For instance, OPIC remains highly constrained by inadequate staffing and outdated authorities. It must rely on congressional appropriations to cover annual administrative expenses (e.g., salaries, travel, and office space), despite generating operating profits on a consistent basis. This de facto constraint has prevented OPIC from fully leveraging its existing capital base in support of US development and foreign policy objectives. In practical terms, this means that roughly $11 billion in development capital remains locked away while more and more US investors are seeking assistance to enter frontier markets, such as Nigeria, Ghana, and Kenya.[iv]

Other traditional players have adapted their development finance tools and are leaving the United States far behind. Well-established European development finance institutions (DFIs) are providing integrated services for businesses, which cover debt and equity financing, risk mitigation, and technical assistance. These European institutions, such as the Netherlands FMO or Germany's DEG, were not originally designed this way. Instead, they have been reformed over the course of decades to ensure that their tools match the needs of investors, businesses, and overall development objectives. The US government, including Congress, can learn from these experiences and push through a number of targeted reforms.

Many emerging market nations have accelerated the trend by establishing development finance vehicles. It is not just European institutions that are pushing ahead. Many emerging market actors – including China, India, Brazil, and Malaysia – have dramatically increased financing activities in developing regions, such as Sub-Saharan Africa, Latin America, and East Asia. The $50 billion Asian Infrastructure Investment Bank, championed by China, has been in the headlines recently. However, it is far from the only example. The $50 billion BRICs Bank, also driven by China, is expected to provide additional alternatives for African nations.

The time has come for a US Development Finance Corporation (USDFC) that would harness America's three greatest strengths: innovation and technology, entrepreneurship, and a deep capital base. My colleague Todd Moss and I have outlined this idea in significant detail in a new Center for Global Development paper released this week.[v] Other think tanks (e.g., Brookings Institute, CSIS, and Council on Foreign Relations), the President's Global Development Council, and private foundations and academics have all advocated similar proposals.[vi] This is a big idea whose time is now.

A reformed and enhanced OPIC would form the foundation of this strategic institution. It also would consolidate a number of other investment-related tools that are scattered across USAID, the US Trade and Development Agency, and other US development agencies. Importantly, the new USDFC would be financially self-sustaining and managed according to market-based metrics.

The USDFC will require bold congressional leadership and a number of targeted reforms. These reforms also would address historical critiques of OPIC, such the appearance of providing corporate welfare and/or crowding out private capital. By simultaneously reforming this pivotal institution and providing it with new authorities and flexibility, the US government would ensure that its development finance tools are fit for purpose in the 21st century.

- *Explicit project approval criteria to ensure that private capital is crowded in, not displaced or crowded out.* Specifically, the USDFC Board of Directors should receive and consider documentation illustrating that the proposed project would not proceed without USDFC support. Such action is essential for avoiding any appearance of corporate welfare. In turn, the institution should report annually on the so-called "additionality" of its operations. In practical terms, this means documenting how its project-level activities helped to catalyze and unlock private sources of capital that would not have happened without USDFC involvement.

- *A presumption of public disclosure on its operational activities and development impact.* There should be a high bar for withholding information due to commercial confidentiality concerns. At a minimum, the institution should publish all project description summaries and project-level development performance data on an annual basis. Such actions would enhance public accountability.

- *Flexible portfolio and staffing levels that uphold rigorous performance and financial management standards.* The institution should not have an ex-ante portfolio target size. Instead, it should have sufficient flexibility to support investments that demonstrate strong development impact, prudently managed financial risks, and clear "additionality" vis-à-vis private sector alternatives. To ensure rigorous congressional oversight, performance metrics covering each of these areas should be reported regularly to the appropriate committees.

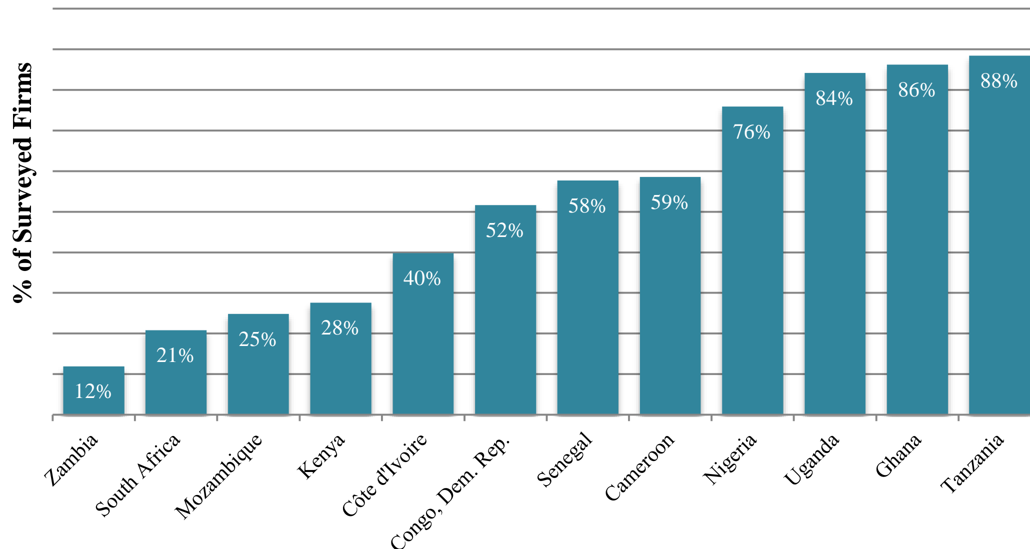
The aforementioned reforms should be actively considered for OPIC even if Congress does not establish a consolidated US Development Finance Corporation. Each of these changes would improve OPIC's operational effectiveness, address past critiques, and enhance public accountability. Therefore, they should be pursued even if Congress does not consolidate other agencies' investment-related tools or provide additional authorities.

RECOMMENDATION 3: PASS THE ENERGIZE AFRICA/ELECTRIFY AFRICA LEGISLATION TO HELP ADDRESS BINDING ENERGY ACCESS CONSTRAINTS ACROSS THE CONTINENT

Unreliable and costly electricity is a major competitiveness and human development constraint in nearly every African country. Roughly 600 million Africans lack access to any form of modern electricity, which greatly reduces economic opportunities as well as health and education outcomes. Half of African firms cite electricity as a major

constraint on their competitiveness, profitability, and expansion potential. In some African economies, losses from power outages amount to more than 10 percent of sales. In addition, greater than 80 percent of firms in Ghana, Tanzania, and Uganda cite concerns with power reliability and affordability.

Figure 4 – African Firms Citing Electricity as Major Constraint, Select Countries



Source: World Bank Business Enterprise surveys

The further expansion of the Power Africa Initiative was the most tangible outcome from the US-Africa Leaders Summit. Based on early progress, President Obama announced a tripling of the original Power Africa targets. The initiative now aims to deliver 30,000 megawatts of power generation capacity and new connections for at least 60 million households and businesses. Unofficially, this could mean up to 300 million people acquiring access to reliable and affordable electricity over time (average household size = ~5 people). These are bold targets and President Obama should be commended for setting them.

US development agencies – including USAID, OPIC, and the MCC – have made tangible progress in implementing the Power Africa vision. Public sector commitments total over $7 billion, mostly from OPIC and the US Export-Import Bank, plus some USAID technical assistance. This has helped to catalyze over $20 billion in private capital from power development companies and investors. The initiative also has leveraged additional investment from other official actors, including $5 billion from the World Bank and $1 billion from Sweden.

The Power Africa team has been strategic in where and how it has deployed scarce US taxpayer resources. USAID has used grant resources selectively, targeting them on sector-level reforms that would enable massive private investments. Supporting Nigeria's power sector privatization plans is a noteworthy illustration. Moreover, USAID, the Commerce Department, and OPIC partnered with leading power developers and legal scholars to develop a model power purchase agreement that could dramatically reduce the amount of time required to bring generation projects to closure. These activities do not

garner much public attention, but they have the potential to deliver massive practical impact with very little US taxpayer money.

In addition, the Obama Administration is rightly focusing on measuring its impact across a range of areas. All effective presidential initiatives – such as PEPFAR, the President's Malaria Initiative, and the MCC – have one thing in common. They have an overriding focus on measuring, tracking, and evaluating the impact of their activities. Power Africa has an initial plan in place, and its core team is thoughtfully developing a comprehensive and rigorous long-term monitoring and evaluation plan. This is not a straightforward exercise given data deficiencies in much of the region. Nonetheless, I am hopeful that they will come forward with a practical plan of action soon that will help to keep the relevant US government agencies accountable going forward.

Further Power Africa progress will partly depend on finding permanent solutions to well-intended, but ineffectual and harmful, US investment regulations. The lack of multi-year congressional authorization for OPIC has put the agency (and US investors), tasked with negotiating complex long-term infrastructure deals, in a state of uncertainty. OPIC has also been unable to reliably support a diversified mix of power generation projects. A carbon emissions cap has effectively pushed the agency out of all natural gas projects in the world's poorest countries. Meanwhile, many African countries are actively exploring for and developing natural gas deposits, which would deliver low-cost and reliable fuel sources. The cap (temporarily lifted in the FY14 and FY15 Appropriations Acts) is undermining Power Africa's potential and dampening US investment abroad. Meanwhile, it is making no meaningful impact on carbon mitigation objectives. All of Sub-Saharan Africa accounts for roughly 2 percent of current global carbon emissions. Even if all African countries adopted zero carbon strategies, it would have almost no impact on global targets. And in the meantime, millions of people in poor countries would be denied access to life-transforming electricity. There are practical compromise options to address this divisive issue.[vii]

Going forward, Congress should strengthen and formalize Power Africa through authorizing legislation, which includes clear reporting targets, multi-year authorization for OPIC, and an exemption from carbon cap rules for the poorest, low-emitting countries. The greatest risk right now is that US momentum will recede after the current administration leaves office. Energy poverty is too long term and too critical an issue to allow that to happen. Passing authorization legislation would make it a durable US development effort and ensure that energy poverty remains at the top of the US-Africa agenda.

CONCLUSION

The US-Africa Leaders Summit was an important moment for our relationship with this increasingly important region. While the Summit had a clear emphasis on promoting economic engagement, largely through greater trade and investment, the subsequent impact on actual US government policy and messaging has been mixed. The Power Africa initiative is a noteworthy example of where ongoing US activities are meaningful and strongly aligned with Africans' priorities.

Congress should advance US efforts to promote economic engagement and development priorities in the region, and push the Obama Administration to do more. First, it should urge the Administration to negotiate legally binding Bilateral Investment Treaties (BITs) with African nations. Second, Congress should consider creating a US Development Finance Corporation or pursuing more modest reforms that would improve and unleash the Overseas Private Investment Corporation (OPIC). Third, Congress should pass Energize/Electrify Africa legislation that promotes US investment in the power sector and seeks to improve economic opportunities along with health and education outcomes. None of these actions entail additional budgetary outlays. Instead, they are strategic, results-based policy tools that would give a significant boost to US-Africa relations.

Endnotes

[i] Benjamin Leo, Robert Morello, and Vijaya Ramachandran (2015). "The Face of African Infrastructure: Service Availability and Citizens' Demands," Working Paper 393, Center for Global Development, Washington DC.

[ii] For instance, Egger and Pfaffermayr (2004), Peinhardt and Allee (2007), and Haftel (2010) find that BITs consistently increase FDI between the associated countries once they are signed and ratified. Salacuse and Sullivan (2005) find that the presence of a US BIT translates into increased FDI to a given country in a given year by 77 percent to 85 percent. Savant and Sachs (2009) argue that foreign investors with exposure to extractive industries often rely on BITs because of the historical experience of host governments behaving in a discriminatory or even predatory fashion. Busse, Königer, and Nunnenkamp (2010) find that BITs likely substitute for weak domestic institutions in developing countries. However, there are other studies that do not find that BITs have a statistically significant impact on FDI flows. These differing empirical results appear to be driven largely by methodological challenges. First, BITs can vary substantially in terms of the quality of investor protections and industry sector coverage. An investment treaty with watered down provisions or large sector carve-outs arguably would have a smaller impact on promoting FDI flows. Second, in some instances, it is difficult to clearly establish whether specific BITs were focused on promoting new foreign investment or on protecting existing FDI stocks after the fact.

[iii] Malaysia and Vietnam are two prospective signatories to the Trans-Pacific Partnership (TPP) agreement, with which the US currently does not have either a BIT or FTA investment chapter in place. Brunei, Japan, and New Zealand are the only other TPP countries without a US investment agreement.

[iv] Under existing congressionally approved authorities, OPIC has a maximum contingent liability limit of $29 billion. As of 2014, OPIC had committed roughly $18 billion of this maximum limit. This means that OPIC could provide an additional $11 billion to support private investment transactions in developing countries.

[v] Ben Leo and Todd Moss (2015). "Bringing US Development Finance into the 21st Century: Proposal for a Self-Sustaining, Full-Service US Development Finance Corporation," Center for Global Development.

[vi] For additional details, see: (1) US Global Development Council (2014), *Beyond Business As Usual*; (2) Brookings Institute (2013), "Strengthening US Development Finance Institutions"; and (3) US National Advisory Board on Impact Investing (2014), *Private Capital, Public Good*.

[vii] For additional details, see Todd Moss, Roger Pielke, Jr., and Morgan Bazilian, "Balancing Energy Access and Environmental Goals in Development Finance: The Case of the OPIC Carbon Cap," CGD Policy Paper 38.