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REFORMING THE LEGAL ENVIRONMENT OF BUSINES IN SUB-SAHARAN AFRICA: MODERATING EFFECTS ON FOREIGN DIRECT INVESTMENT

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Abstract

Purpose: This paper discusses some of the contending issues in the legal environment of business in Sub-Saharan Africa (SSA) as they relate to Foreign Direct Investment (FDI). Given that 'fear of national laws' has been consistently cited as a major factor inhibiting foreign investments in the region, this paper argues that 'arbitration/alternative dispute resolution' (A/ADR) offers a strategically complementary adjudicative system to mitigate this adverse perception.

Design/methodology/approach: Based on a synthesis of the literature, the paper, first, outlines the emerging A/ADR-driven trends in global business. From this premise, it focuses the market transition challenges facing SSA and identifies the disparate regional legal systems, with their backgrounds and origins in common, civil and Islamic laws, as primary issues of concern.

Findings: Apart from lacking uniformity in application, the legal strictures have made the resolution of legal and contractual obligations much more cumbersome and expensive, thereby discouraging significant FDI flow to SSA.

Research limitations/implications: The need to secure the confidence of investors by reforming the law and the adjudication process appears compelling. However, the socio-cultural considerations that should naturally embed effective arbitral protocols are not addressed in this paper.

Originality/value: A/ADR mechanism is not presently a key feature in the legal environment of business in SSA. However, it is likely to prove a more functional adjudication process than the procedural formalities of litigation. By its characterization, this approach promotes the creative implementation of a "home-grown" framework for commercial dispute resolution, thus avoiding the drudgeries of litigation but at the same time providing the needed catalysts for enabling FDI.

Key words: Law reform, business environment, arbitration/alternative dispute resolution, foreign direct investment, sub-Saharan Africa.

Introduction

As a private judicial or quasi-judicial process, Arbitration/Alternative Dispute Resolution (A/ADR) gained prominence in the United States in the 1970s. This was primarily spurred by a desire to avoid the cost, delay and adversarial nature of litigation in a cultural environment that is still believed to be litigation-happy. Similar to the experience in the US, interests in A/ADR in many countries stems from a desire to revive and reform traditional mechanisms of judicial resolution, which have become expensive, cumbersome, inflexibly formal and time-consuming. Hence, leading commercial nations today have treaties and laws permitting arbitration and specifying the effects of arbitral awards. Examples include the US Federal Arbitration Act; the British Arbitration Act, which came into effect in 1996; the Arbitration Law of the People's Republic of China that became effective in 1994; and the Russian arbitration law that was enacted in 1993. Indeed, the referent laws of many countries (e.g. China, Russia and Canada) were patterned after the 1985 Model Law on International Commercial Arbitration of the UN Commission on International Trade Law (UNCITRAL).

In addition, there are arbitration treaties in force worldwide: e.g. the Arab Convention on Commercial Arbitration (1987); the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1959); the Convention on the Settlement of Investment Disputes Between States and Nationals of other States (the Washington Convention of 1966); the European Convention Providing a Uniform Law on Arbitration (the Strasbourg Convention, 1966); the Geneva Protocol on Arbitration Clauses (1923); Geneva Convention on the Execution of Foreign

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Arbitral Awards (1927); and the Inter-American Convention on International Commercial Arbitration (Organization of American States, Panama Convention, 1975). Thus, there is a clear evidence of a huge body of international treaties, especially from commercially significant countries, (these countries are home to over 85% of Multi-National Enterprises, Hill 2005) that have essentially embraced A/ADR as a procedural business disputes resolution alternative to litigation.

These developments hold out important lessons for countries in Sub-Saharan Africa (SSA). The nations of SSA are so heavily in debt that it is critical for them to attract long-term capital flows from foreign investors. Whilst the urgency to accelerate FDI inflow to SSA is not in doubt (Trent, 2002), the aura of uncertainty surrounding international commercial transactions continues to hamper progress. This needs to be eliminated because FDI will not be sustained unless national policies ensure that the basis for international production and exchange is supported by improvements in institutional environments. Essentially, the credibility of the legal institution is widely accepted as important determinant of FDI attraction. In studies of FDI in SSA (e.g. Nyikuli, 1992; Trent, 2002), fear of national laws has been cited as a major factor inhibiting investment in the region. Based on this problematisation, this paper argues that A/ADR is a strategic approach that is not only capable of mitigating the adverse perception of business-legal environments but also offers an alternative and complementary adjudicative system.

Sub –regional relevance

SSA is on the margins of the world economy because of its lack of competitiveness and economic diversification (Nwankwo and Richards, 2001). Over the past decade, SSA received less than 10% of total capital flows to all developing countries. Nevertheless, the promotion of FDI as an engine of economic growth, along with trade liberalization and the formation of regional economic groupings remains crucial to the wellbeing of the economies of SSA. In an attempt to encourage FDI, many countries embarked on large-scale institutional reforms, with the overarching goal of creating an investment-friendly business environment. Paradoxically, despite improvements in the policy environment, share of the global FDI going to SSA has not improved much, prompting some researchers to question whether the factors that influence FDI in developing countries affect SSA differently (Asiedu, 2002).

Essentially, promoting macroeconomic stability, structural reforms, privatisation and poverty reduction are now key policy issues for most countries. Following the widespread implementation of SAP in the 1980s/90s, the sub-region seemed ripe for FDI. The hope was that a substantially implemented SAP would open the door to massive private investment. Rather disappointingly, expectations have not matched the reality on the ground as investors, especially foreign, have in large part viewed and approached the sub-region rather cautiously, if not trepidatiously (Nwankwo and Richards, 2001). One of the reasons generally adduced, amongst others, is the lack of relative uniformity and cumbersome legal strictures for the enforcement of contractual obligations and property rights in the contiguous states that make up the sub-region (World Bank, 2002). The significance of this to MNEs can only be appreciated in the context of market size, experience curve and economies of scale sensitivities of their operations.

For SSA, the demand of the competitive global economy means that it is not enough to improve the policy environment alone. Improvements should be made both in "absolute and relative terms" (Asiedu, 2004, p.41). Increasingly, the global environment is characterized by an abundance of arbitration laws and treaties amongst countries that reciprocally enjoy the 'most favoured nations' trading status under the World Trade Organization framework. The questions that arise are: how, in the aftermath of SAP (which substantially entailed privatization and deregulation), can the various litigation processes and arbitration alternatives be synergized in simplification to stimulate invest-

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ment? How might this, in turn, lead to strengthening and securing the weak attributes of property and contractual rights' protection laws in order to promote FDI? The critical component here is to assure investors of a simpler and inexpensive but reliable adjudication process. As observed by the World Bank (2003), "...retaining Africa's wealth and attracting foreign wealth will require deeper assurance on property rights and enforcement of contracts; strengthening financial systems and rights of creditors..."

Therefore, identifying a relatively uniform, reliable and less cumbersome framework has gained currency and urgency and, indeed, acceptability within the business community, especially the MNEs. Understandably, these MNEs must operate across sub-regional national boundaries to be viable. This requires an acceptable level of convergence or harmonization in the business dispute resolution process as well as property rights' protection. Expectedly, the process must be generally applicable and complementary to currently expanding market size as well as enhance economies of scale operational viability. It is worth reemphasizing the point that MNEs are the most critical segment to court in any meaningful economic or market development initiative in SSA and, indeed, the continent as a whole (Asiedu, 2004).

It should be noted that the emphasis here is not Small and Medium Enterprises (SMEs), which are generally believed to be the most dynamic and responsive engines of economic growth in any national or regional market dynamics, both in their employment potential and GDP-generation quotient (Scarborough and Zimmerer, 2005). Their significance run a gamut, from overall economic and market growth, to providing the seedbed for industrialisation, employment generation and entrepreneurship (Grosh and Somolekae, 1996, 1994; McPherson, 1994; Levy 1991). Unfortunately, this has not been the experience in SSA because of the peculiarly suspect and sometimes questionable resource and capital accumulation patterns of the typical indigenous investor, the result of which accounts for the current trend in reverse capital flight phenomenon. For example, over 37 per cent of Africa's private wealth is domiciled outside the continent (World Bank, 2002).

The crux in perspective

The importance of A/ADR is better appreciated by looking at the role businesses must play in the economic and market development of Africa, and by extension, the region's participation in the global economy. It is also important to appreciate the indispensability of A/ADR for businesses within the context of the pan-regional initiatives for promoting economic opportunities (e.g. the New Partnership for Africa's Development, NEPAD, and Economic Community of African States, ECOWAS).

The point to note, of course, is that the legal systems in much of the countries in Africa have their origins in a combination of common law, civil law and Islamic laws. The result is that for MNEs, these disparate legal systems create myriads of contractual, legal and judicial hurdles in doing business across the multitudinous national boundaries within the sub-region. Concomitantly, the difficulties are more severe when investors are expected to conform to these laws in their oftentimes conflicting national variations. It seems, therefore, that the only way SSA will be attractive to foreign investment is for it to be visualized and evaluated in terms of a single, virtual, boundary-less and non-restrictive single market. This may be a tall order but, nevertheless, an inescapable requirement. It is clear that the attractiveness of Africa as a viable alternative to emerging Eastern Europe and South East Asia is crucially dependent on the entrenchment and harmonization of the various and seemingly competing legal strictures. If this condition is met, then one of the most critical components and, to a large extent impediment, in the creation, implementation and enforcement of contractual obligations will be made easier and more manageable. The suggestion here is for a

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fundamental substitution or modification of the current legal and judicial processes, with a view to evolving a more business-friendly disputes resolution process that is attractive to investors.

Legal systems and conducive business environment

The role of a more business-sensitive judicial adjudication process in commerce was long ago recognized by the 6th Century English philosopher, Thomas Hobbes. He argued that without a judicial system, traders would be reluctant to enter into wealth-enhancing exchanges, for fear that the bargain would not be honored. In Hobbes' words, when two parties enter into a contract, "he that performeth first has no assurance the other will perform after because the bonds of words are too weak to bridle men's ambitions, avarice, anger, and other passions without the fear of some coercive power" (quoted in Messick, 1999).

Development economists have since revived Hobbes's thesis by giving it a more current perspective within the context of a global economy. For example, North (1990, p.54) asserts that the absence of low-cost means of enforcing contracts is "the most important source of both historical stagnation and contemporary underdevelopment in the Third World". Williamson (1995), on the other hand, is of the view that a "high-performance economy" is one that is characterized by a significant number of long-term contracts - just the type of business relationship that is unlikely to thrive in the absence of a well-functioning judicial system. When the judiciary is unable to enforce contract obligations, a disproportionately large number of transactions take place in the spot market, where there is less opportunity for breaching contracts. In the alternative, firms circumvent the judicial system altogether by vertical and conglomerate integration, turning arms-length transactions into intra-firm ones. In either case, argues Williamson, the results are higher transaction costs and a "low-performance economy." Very few profiles more succinctly describe SSA's business environment.

Indeed, empirical evidence from Ghana also supports Williamson's argument, that is, the absence of a reliable and functional judicial system raises transaction costs, among other things (Williamson, 1995). As reported by Fafchamps (1996), businesses in Ghana rely upon a network of traders to serve as go-betweens. For example, rather than solicit a supply of lumber, say, from an unknown company directly, a firm will enlist a trader that it knows and who, in turn, knows the lumber company. The personal relationships provide the buyer and seller with some assurance that the lumber will be delivered and payment received, but at a price. Inadvertently, but inevitably, the creation of intermediaries raises the costs of doing business. Herein lies the case for A/ADR. However, the phenomenon Fafchamps (1996) describes is more amenable to small-scale transactions and may not be attainable in an arm's length, large-scale transactions for which MNEs are known, and whose impact would be much more significant for market expansion in SSA.

Regional legal systems need a fundamental improvement to make them more sensitive to the requirements of the global market place. This should go beyond rhetorical admonition at fighting corruption. Indeed, surveys in SSA show that four out of five businessmen lack confidence in the independence and impartiality of the judiciary (World Bank, 2001). This indigenous perception speaks volumes to the larger fears and discomfort and extreme reluctance of the foreign investor. For example, in a survey of 3,600 firms in 69 countries, more than 70 percent of the respondents said that an unpredictable judiciary was a major problem "in their business operations" (World Bank 1997, 36). The report also found that the overall level of confidence in the institutions of the government, including the judicial system, correlated with the level of investment and measures of economic performance (World Bank, 1997). More recently, Kumasa and Mbeche (2004) established that whereas institutions have played a greater role in the economic development of several East Asian countries, they are weaker and ineffective in Africa because of poor enforcement of the rule

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of law, corruption, mismanagement, absence of strong civil society and political interference. Well-functioning institutions can promote growth and reduce poverty in SSA by providing a conducive environment for FDI and sustainable development programmes.

The thrust, therefore, should be to evolve policies that seek to remove these perceived environmental disenablers and allow businesses to determine their own business and contractual dispute resolution, for example, by creating an alternative process that is embodied in A/ADR. Perhaps, it is in this context that one is better able to appreciate the current and urgent pre-occupation between business and other stakeholders at finding a functional substitute or alternative that best blends the substantive and procedural formalities of a legal adjudication process with a much more informal process, albeit predictable, reliable and enforceable system - liberally borrowing from both without being unduly encumbered by either. It must also be an alternative that has origins in the substantive culture or norms of the African traditional dispute resolution process; one that is not inherently adversarial but more conciliatory and mediation-heavy, even as it blends the cultural nuances of diverse foreign investors.

Nurturing and sustaining indigenous (home grown) alternative

As an "alternative" practice, A/ADR appears to have a significant role in the United States and other developed countries for commercial dispute resolution. This is spreading internationally as a business imperative, largely driven by the forces of globalization and the attendant demands for harmonization and convergence of the different legal systems. In the last decade, for instance, more countries have passed legislation based on the 1985 UNCITRAL Model Law on International Commercial Arbitration, which makes an arbitral award legally binding and grants broad rights to commercial parties choosing arbitration. Yet, critics argue that arbitration, once considered an alternative to litigation, is now afflicted with the same problems of cost, delay, complexity, and dependence on legal representation (Brooker 1999, Mitchard 1999). This argument misses the point mainly because arbitration, although not a substitute for litigation, is a more business-friendly alternative – its usefulness and practical application seeks to bridge and harmonize different institutional perquisites (common, civil, and Islamic law). It does this by creating a relationship and sensitivity component that equitably delivers promptly on business dispute resolution and significantly eliminates the uncertainty and delay in an otherwise protracted litigation process.

Furthermore, Kranton and Swamy (1999), notes that the lesson is not that judicial reforms, premised on evolving a functional and effective A/ADR), are inappropriate. Rather, where crucial market segments are missing, such as those for insurance and futures market, care must be taken to ensure that judicial reform does not have unintended consequences. In other words, there should be flexibility about the process that is accommodative of unforeseen market or business exigencies. It seems the case that the hallmark and attractiveness of A/ADR lies in its inherent demand for flexibility and applicability, that is, the embedment of relative informality and pliability. Fafchamps' (1996) study of contracting in Africa supports this view. He found that rigid compliance with the terms of a written contract was difficult, if not impossible, in developing countries. The economies are simply subject to too many exogenous shocks for contracts to be strictly enforced. This is why informal contract enforcement mechanisms, which A/ADR embodies and encourages, must be built in to allow for such flexibility.

The former General Counsel of the World Bank, Ibrahim Shihata, (Shihata, 1991), also noted that a prerequisite for a functioning legal system (or what he called rule of law) must not only necessarily indulge mechanisms to ensure proper application of rules but should also allow controlled departure when deemed necessary. Also, in a speech in September of 2000, the World Bank President, James Wolfensohn, declared that a government must ensure the rule of law and that no equitable develop-

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ment is possible without it (World Bank, 2000). In SSA's context, market development purposes require a simplification of the 'rules of engagement' in an acceptable alternative form, preferably A/ADR.

Admittedly, reform (or a functional "home-grown" alternative) is as complicated as it is desirable, hence the need for one that not only attends to the competing, entrenched, interests (usually the "rentier" professional class), but also delivers on reform alternatives (e.g. A/ADR). Perhaps predictably, reform may engender opposition from the nation's organized legal or other professional groups. In Uruguay, for instance, lawyers objected to the introduction of procedures that would speed up civil and criminal trials, fearing that speedier trials would mean less work for them (Vargas 1996). Reform can threaten lawyers' and other professionals' incomes in other ways as well. For instance, the practice of law is almost invariably a state-sanctioned guild or cartel, but as Posner (1995) explains, unlike an oil or steel cartel, "legal services" are difficult to define. The nations in our continental context must, therefore, specify what tasks are for lawyers and what tasks can be performed just as well by non-lawyers. In Peru, for example, attorneys and public notaries vigorously opposed measures to cut the costs of registering land belonging to the urban poor because the measures would allow engineers, architects, and other professionals to provide services that had once been the exclusive preserve of the legal profession (World Bank 1997).

In view of the fact that A/ADR is a process whose promise and efficacy is predicated on its capacity to blend diverse expertise and professional backgrounds to deliver equity rather promptly and relatively inexpensively, it follows that a "home-grown" alternative must be one that seeks the institutional support of the various regional governments and professional bodies, who must appreciate need-complementarities, as opposed to inter-professional competition. It must also be an alternative that appreciates the critical dependency nature of their services to businesses, as they enable the delivery of equity to the customer or the ultimate consumer. Indeed, consumers in SSA are desperately in need of much equity in the quality and delivery of goods and services. It is also important to note that the region boasts one of the lowest literacy levels, per capita, of any developing sub-region (World Bank, 1991). Obviously, this would impact the adequacy and perhaps quality of legal representation in a purely litigation-dominant environment – hence the need for cooperation across professional boundaries.

State-sanctioned processes

A dominant view holds that economic development depends upon a legal system in which contracts between private parties are enforced, property rights of foreign and domestic investors respected and the executive and legislative branches of government operate within a known framework of rules (World Bank 1992, 1994, 1997; Dakolias 1996; and Shihata 1995). It has also been suggested that this way of defining the rule of law assigns a prominent place to the judicial system. "The judiciary is in a unique position to support sustainable development by holding the other two branches accountable for their decisions and underpinning the credibility of the overall business and political environment" (World Bank 1997, p.100). The real issue is not so much the seeming needlessness or redundancy of an alternative process but, rather, the strengthening and consolidation of the formalist legal system by the inclusion of the A/ADR process. Regrettably, the contradictions and, indeed, the reality is that the formal judiciary, endowed with so much predictability and reliability, appears to lack this hence the suggestion for augmentation with A/ADR. Although not incurably deformed, the formalist strictures in SSA is debilitatingly handicapped and lacking in its ability to be promptly responsive to businesses' need, at least, in the perceptions of the investment community. Therefore,

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there is need for a states'-sanctioned, purpose-directed reformation initiative that is targeted at business-related dispute resolution.

The Japanese experience can be viewed as the *locus classicus* of a state-sanctioned exercise in business-sensitive resolution process, an initiative akin to arbitration in the sense of its level of simplification and applicability. Japan saw tremendous economic growth in the last century despite a lack of formalist rule of law strictly so-called. However, theirs appears to be an extremely unique cultural environment that is different from the diverse cultures in which many MNEs operate. For instance, the number of lawyers per capita and amount of litigation in Japan have decreased markedly since the 1930s. Paradoxically, economic growth has exploded in roughly the same period. This suggests, in the views of Upham (2001), that "formal legal rules" have very little to do with economic growth. The Japanese have largely kept the formal legal system away from the economic sphere by embracing a resolution alternative akin to an informal A/ADR process. This has allowed an appreciable degree of interaction between bureaucrats in the powerful Ministry of International Trade and Industry, politicians, and private business to guide economic policy. The Japanese also rely on a system of informal mechanisms to handle most individual and business disputes. At rare times, courts have been used as a "political safety valve," such as the Big Four Pollution Cases of the 1970s. Indeed, because of its extensive reliance on informal mechanisms, the Japanese legal system could serve as a persuasive model for developing countries (Upham, 2001). It is hard to escape the conclusion that countries in SSA would reap FDI rewards by being receptive to a model embodying a mixture of formal (formalistic) rule and the informal (A/ADR) processes.

Conclusions

The continent of Africa has witnessed its share of market and development vicissitudes. It is debatable whether the exercises in variable reforms have achieved the anticipated outcomes. However, a strong case can be anchored in Madavo (2002) who canvasses and indeed predicated better chances of success on institutional rather than structural reforms. He argued that market transition, with FDI as part of a measurable parameter, is critically dependent on the creation of a stable and business-friendly environment. Consequently, the sub-regional judicial and litigation system that is universally adjudged unpredictable, unreliable and prohibitively cumbersome must, therefore, be reformed not only to be sensitive to business needs but also allow for sub-regional convergence, harmonization and integration.

What is evident, and instructive too, is a recurrent theme that now sounds like a refrain in extant literature. That is, securing features like "property rights", "enforcement of contracts", "strengthening financial systems and the rights of creditors", etc, are absolutely necessary for the possible success of any new initiative to transform Africa into a more conducive environment that is sufficiently competitive and attractive to foreign investment. A/ADR must be part of that complementary process. Substantially, a great deal would depend on legal and judicial reforms, vis-B-vis, their successful transformational relevance. For an institution and process so entrenched and deeply rooted in formalist rule of law, and time being of the essence, A/ADR must rapidly evolve with the urgency of a 'critical default alternative' to litigation. It must be perceived as embodying Africa's rich traditional dispute resolution origins, whilst at the same time wearing the inclusive sensitivity of a global business perspective. SSA can only become viable and attractive to the investment community when those critical components (legal, contractual rights, property rights, etc.) that carter to business are indigenously and sub-regionally reformed, with a single-minded focus on attracting FDI, as well as indigenous investors. This would go a long way in helping to realize an important part of the Millennium Development Goal of poverty alleviation (DFID 2000; Nwankwo and Richardson, 2004).

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