



The World's Largest Open Access Agricultural & Applied Economics Digital Library

This document is discoverable and free to researchers across the globe due to the work of AgEcon Search.

Help ensure our sustainability.

Give to AgEcon Search

AgEcon Search
<http://ageconsearch.umn.edu>
aesearch@umn.edu

Papers downloaded from AgEcon Search may be used for non-commercial purposes and personal study only. No other use, including posting to another Internet site, is permitted without permission from the copyright owner (not AgEcon Search), or as allowed under the provisions of Fair Use, U.S. Copyright Act, Title 17 U.S.C.

No endorsement of AgEcon Search or its fundraising activities by the author(s) of the following work or their employer(s) is intended or implied.

INTERNATIONAL ECONOMIC PROSPECTS

AFRICAN HUNT FOR INVESTMENT: ANY CHANCE FOR SUCCESS?

IGNATY DYAKOV, M.S.

University College London, UK

JEL Classifications: F21, O55

Key words: FDI, Africa, determinants, policy recommendations

Annotation: During recent two decades the world has witnessed a drastic increase in global FDI inflows. Gradually more and more investment has been directed to the developing countries in the attempt to diversify portfolios and use finance in the most efficient way. Not all developing regions of the world perfectly succeeded in attracting FDI. Large by labor force and territory, abundant in natural resources Sub-Saharan Africa could perform much better in this aspect. This paper once again reviews the opportunities for FDI in Africa and suggests possible ways for authorities of African states to overcome the existing situation.

Introduction

Unless considering the recent financial crisis¹, one could see a drastic increase of foreign direct investment (FDI) during the past two decades. Analysts and scholars have paid much attention to FDI into developing countries, which could offer rapid response to the investments and at the same time give possibility to significantly diversify the investment flows both geographically and by spheres. FDI lets multinational enterprises lead business more efficiently and gives an opportunity to raise the scale of business, to broaden it. Even rising during this period globalization has not changed this tendency, on the opposite, it may be even stimulating new more active foreign investments into various developing countries. As experts say, the shift in motivations and, consequently, determinants of FDI may have occurred with the new era of globalization - from market-seeking and resource-seeking FDI to efficiency-seeking FDI (e.g., UNCTAD Report (1998)), but the global volume of investment flows have been only increasing (in 2007 it rose by 30% up to \$1,833 billion, as compared to \$1,400 billion in 2000 and around \$200 billion in the beginning of 1990s)².

From the viewpoint of investment recipients, scholars actively argue that FDI inflows bring economic growth, development and welfare to the host countries. This makes consultants and policy-makers invent new ways for attracting foreign investors,

analyze the determinants of FDI and apply obtained knowledge, put the recommendations into practice.

Usually analysts prefer to speak about attractiveness or unattractiveness of certain countries or even regions. And only then within these countries they distinguish attractive or unattractive spheres to invest. Actually despite of the large varieties of businesses the number of spheres for foreign investments is relevantly low. They are natural resources (both import and export), infrastructure, manufacturing, and certain services.

Gradually more and more global foreign investment flows has been directed to the developing countries in the attempt to diversify portfolios, diminish risks and use finance in the most efficient way. Not all developing regions of the world perfectly succeeded in attracting FDI. Large by labor force and territory, abundant in natural resources Sub-Saharan Africa could perform much better in this aspect.

This paper tries to address the questions whether countries to the south of the Sahara may still be of interest for foreign investors, what unification of forty eight countries under the common name "Sub-Saharan Africa" gives to investors and to African countries themselves, what may be the policy recommendations for their governments.

For the purposes of this paper UNCTAD definition of FDI will be used, i.e. FDI as "an investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity in one economy ([the] foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor..." (UNCTAD, 2003).

What opportunities for FDI in Africa?

Dunning (1993) identified three possible motivating factors for foreign investments:

¹ According to the latest UNCTAD Press Release (24.06.2009), global FDI inflows and cross-border M&As - the main mode of FDI - significantly declined in the fourth quarter of 2008, and the decrease has continued in 2009 (by 54% and 77% correspondingly during the first quarter of 2009 as compared to the same period of 2008).

² Data from FDI/TNC database www.unctad.org/fdistatistics.

- Resource/asset seeking FDI: these FDI are made to acquire resources that are not available back in the home country. In this category availability of skilled and unskilled labour, its productivity and cost are included alongside with natural resources and raw materials;

- Market seeking FDI: these FDI are made for serving local and/or regional markets. Host countries' characteristics which can attract market seeking FDI include market size of the recipient country, per capita income and market growth (including potential);

- Efficiency seeking FDI: this kind of FDI occurs when an enterprise is planning to get higher profit from the common governance of geographically dispersed activities and diversification of risks.

Africa, by some unbelievable coincidence, obtains huge potential for all and each of these three motivations for investors. It possesses significant reserves of oil, gas, gold, diamonds, copper. 80% of the world's platinum and chromium, 50% of manganese and cobalt, about 30% of bauxite are disposed in the continent's interior. This region is one of the main sources of cocoa, coffee, sugar, flowers, not mentioning other agricultural products.

It is inhabited by almost one billion people. They are not educated to the sufficient level yet, but this makes them work for quite decent reward. They live short (approx. 53 years comparing to world average 67 years) due to low quality of life, which is negatively affected by poor sanitation, lack of potable water, HIV/AIDS, malaria, starvation. And these issues should be addressed, especially, since relevantly moderate resources are needed for solving some the most crucial of them, like access to water, prevention of malaria and HIV, sanitation. So, nowadays there are a large proportion of able-bodied citizens, and investing a certain amount of money into solving mentioned above problems would even improve this labour force.

The same people, having jobs and, consequently, stable income, are perfect customers, to whom those seeking new markets may pay attention. Almost any product with a reasonable 'price-quality' ratio, which may find severe competition in other markets, will be welcomed in Africa.

There is said to be rather poor infrastructure in Africa. This notion includes transport facilities, roads, railways, and telecommunication, Internet. Obviously, now it presents certain risks and inconvenience for investors. Nevertheless, with so intensive deployment of cellular and satellite communications, the problem of data transfer seems to be temporary. As to transport facilities, it needs more effort, resources and time, but still if China is able to expand its roads network by 240,000-280,000 kilometers in every five years, what theoretically can prevent from building at the same speed in Africa? It is worth mentioning, that China has already participated in road-building in a number of African countries (Ethiopia, Kenya etc.).

Policy recommendations

There have been many papers published on determinants of FDI in Africa (e.g., Asiedu (2002), Morisset (2000), Mwilima (2003)). It has no sense to copy here their results, based on empirical research. What can appear here is a generalized overview of certain issues, which may be united by one word "information".

Economic growth and price stability do promote the FDI inflow to Africa. But it is hard to achieve both these goals at the same time. There should always be a trade-off between them. Probably, in the current economic situation and with the goal to achieve some social stability, which will contribute to political stability as well, it is likely to be more reasonable to focus on the economic growth. This will create more working places and thus diminish high unemployment in the region. Onyeiwu and Shrestha (2004) cite as an example the Chinese experience, where a stellar growth rate generated a huge flow of FDI that more than compensated for the decrease in the flow of FDI precipitated by inflation. The information about the pace of economic growth should be disseminated as wide as possible; the level of employment, statistical data on the professional experience of those employed should also be widely available.

Then the governments of African countries should understand what interesting features their countries have, what type of investors they may attract, i.e. to start from motivations that may have investors. There are some common features among countries to the south of the Sahara, but there are those as well, that differ them significantly. Therefore it may be important to go away gradually from the image of Africa as a single whole, the image, which nowadays prevents more intensive investing even into comparatively developed countries of the region. It is a huge continent, where more than fifty countries are located. They differ by the availability of natural resources, geographical location, current economic situation, population, its health and education level, cultures, traditions etc.

What can be done by the international community and to some extent by African states themselves it is strict separation of African regions in the news. Nowadays it is quite common to speak about some conflict in a particular country (let's say Eritrean-Ethiopian border conflict or civil war in Sudan) as a conflict in the African continent that immediately makes the image of Africa as a place of regular wars, conflicts, military interventions, instability and consequently major risks. This way of reporting, if eliminated, may play an important role in forming general information field for decision-makers. The Roman principle "divide et impera" ("divide and conquer"), changed to "dividere et impera" ("get

divided and conquer”), would perfectly suit in this case.

The mentioned factors themselves may say about what motives will have investors; and then they help to distinguish what measures, policies should be undertaken to emphasize attractiveness of the country and minimize drawbacks and negative sides. This analysis along with the analysis of potential investment home countries interests may give much more effect than just applying methods, which were successful in other regions. Tailoring to the certain circumstances and current situation seems to be important with regards to attracting FDI.

For instance, what may Russian and Chinese companies be looking for in Africa? What motives may have companies from these countries, which since recently show quite significant interest in coming (or coming back - in case of Russia) to the continent? In both countries business is closely connected to the government, so political interests seem to be quite important for business decision-makers. This emphasizes general trends for investment coming from these countries. Russia is eager:

- to get out capitals, which it acquired during the recent ten years or so, to diversify the risks and at the same time to get maximal profit;

- to export high-tech production (military, medical, or dual-purpose);

- to get the leadership position in some spheres (for instance, in gas exploitation etc.);

- to broaden the business (TNC);

- to import some natural resources (Mn, Al etc.), but it is not an importer of major natural resources. This motivates Russia to be interested in assisting African countries use gas, oil and other natural resources for internal needs (in this context the visit of the Russian President to Angola, Nigeria and Namibia earlier this year is quite eloquent). If this happens, Russia has no more competitor for export to European Union, to China and other countries increasing their production and therefore requiring resources. This may mean that Russia is interested in developing infrastructure projects in the region;

- to export knowledge: not mentioning the creation of economics of knowledge, but even African students, who return from Russia, may more willingly use Russian technological resources later on.

In its turn China is looking for:

- export of production (usually cheap);

- getting natural resources and raw materials for increasing production;

- diversifying supply of oil and gas and securitisation of agricultural supplies;

- employment for the Chinese (sometimes up to 70% of employees in Chinese invested projects in Africa are the Chinese);

- export of labour force;
- need for loyalty for further global expansion.

Right understanding of other countries' national interests can help African authorities to work out more precise and targeted strategy for attracting investment from certain regions.

Good competition between African countries for attracting FDI is necessary and seems to be useful, at the same time competition does not mean that winners get all the investment, while losers happen to be out of the game. This game is not zero-sum and, luckily, this means that FDI are not attracted only at the expense of another country, so there is a good chance to get FDI if one needs them and wishes to make the best to achieve this.

If an African country wants to attract more FDI, its liberal policies may be made more credible with the assistance of international institutions (WTO/GATT etc.). The role of organisations of this kind, their positioning is important, so the information that they offer seems to be credible to decision-makers. Membership in WTO or whatever will indirectly reassure foreign investors and help to attract more FDI inflows, though the government should take into consideration that they may pay for this with the loss in policy autonomy. The adoption of international accounting and banking standards might establish transparent and consistent economic system and thus help those from outside to understand what is happening in the country. While choosing the destination for investment, comparing African countries with others, this will let measure them by the same methods and with less approximation.

Conclusion

Sub-Saharan Africa is a large region by territory, labour force, abundant in natural resources. With no doubts it has huge potential for future development and at the same time nowadays it suffers from a number of problems, which transfer into risks and reasons for doubts for foreign investors. Among others, there are poor infrastructure, low quality of life, HIV/AIDS, insufficient education level, conflicts, weak institutions etc. But these risks - besides being able to be solved in a reasonably short period and with decent resources - are disseminated all over Africa and differ by prevalence from country to country. The diversity is quite vast: from dynamically developing and comparatively prosperous South Africa, Botswana, Nigeria to those having more issues to be addressed like Central African Republic, Eritrea or Rwanda. In the era of globalisation, when the information field is one of the most important instruments of decision making, unification of about fifty countries by one name 'Africa' makes more harm than has utility. It would be more reasonable, practical and informative for both authorities of recipient countries and investors

to go away from such unification, to look at countries, or at least bunches of countries, as they are on their own. Investors perceive liberalisation, economic, political and social reforms as necessary elements, but they need more information on what happens in the countries. And this information seems for them more reliable if supported by the opinion of some third party. Therefore movement towards joining WTO/GATT and analogous organisations may be regarded as a positive signal. There have been lots of examples of getting FDI, various in details ways of attracting them and implementing different policies for this in the world during the recent twenty-thirty years. African authorities now have a marvellous opportunity to use this previous knowledge, make some conclusions from obtained by others experience, at the same time, however, elaborating their own unique schemes.

References

African Competitiveness Report, 2004. Ed. by Ernesto Hernandez-Cata, Geneva, World Economic Forum

Asiedu, E., 2002. "On the Determinants of Foreign Direct Investment to Developing Countries: Is Africa Different?", *World Development*, Vol.30, No.1, pp.107-119.

Basu, A., Srinivasan, K., 2002. "Foreign Direct Investment in Africa - Some Case Studies", IMF Working Paper, March.

Braunerhjelm, P., Svensson, R., 1996. "Host country characteristics and agglomeration in foreign direct investment", *Applied Economics*, Vol. 28, pp. 833-840.

Blonigen, B.A., 2005. "A Review of the Empirical Literature on FDI Determinants", <http://darkwing.uoregon.edu/~bruceb/FDISurvey2.pdf> [accessed 22 August 2009].

Buthe, T., Milner, H., 2008. "The Politics of Foreign Direct Investment into Developing Countries: Increasing FDI through International Trade Agreements?", *American Journal of Political Science*, Vol. 52, Issue 4, pp.741-762.

Chakrabarti, A., "The Determinants of Foreign Direct Investment: Sensitivity Analyses of Cross-Country Regressions", *Kyklos*, 54, 1, 2001, pp. 89-113.

Dunning, J., 1993. "Multinational Enterprises and the Global Economy", Harlow, England.

Hanson, S., 2008. China, Africa, and Oil, <http://www.cfr.org/publication/9557> [accessed 22 August 2009].

Morisset, J., 2000. "Foreign Direct Investment in Africa. Policies Also Matter", *Transnational Corporation*, 9, 2, pp.107-125.

Mwilima, N., 2003. "Foreign Direct Investment in Africa", Social Observatory Pilot Project - Final Draft Report, September, pp. 29-45 <http://www.sarpn.org.za/documents/d0000883/P994-African_Social_Observatory_PilotProject_FDI.pdf> [accessed 22 August 2009].

Ngowi, H., 2001. "Can Africa increase its Global Share of Foreign Direct Investment (FDI)?", *West Africa Review*: Vol.2.2. <<http://www.westafricareview.com/vol2.2/ngowi.html>> [accessed 22 August 2009].

Nunnenkamp, P., 2001. "Foreign Direct Investment in Developing Countries. What policymakers Should Not Do and What Economists Don't Know", *Kieler Discussionsbeitrage*, 380, <<http://opus.zbw-kiel.de/volltexte/2006/3849/pdf/kd380.pdf>> [accessed 22 August 2009].

Nunnenkamp, P., Spatz, J., 2002. "Determinants of FDI in Developing Countries: Has Globalization Changed the Rules of the Game?", *Kieler Discussionsbeitrage*, 1122 <<http://opus.zbw-kiel.de/volltexte/2008/7138/pdf/FDI-determinantsNuSpatzTNC.pdf>> [accessed 25 August 2009].

Onyeiwu, S., Shrestha, H., 2004. "Determinants of Foreign Direct Investment in Africa", *Journal of Developing Societies*, Vol. 20, pp.89-106.

Thomsen, S., 2005. "Foreign Direct Investment in Africa: the private-sector response to improved governance", *International Economics Programme Briefing Paper 05/06*, Chatham House, <http://www.chathamhouse.org.uk>

UNCTAD Report, 1998.

UNCTAD Report, 2003.