FOREIGN DIRECT INVESTMENT IN AFRICA

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Abstract: Most African countries are seeking Foreign Direct Investment (FDI), because of the contribution FDI can make to their economic development and integration into the world economy. If well managed, FDI can be a channel through which African countries stimulate and sustain their economic growth rates. It is important to identify factors that have the potential to either impede or induce FDI flows into host countries. It is also important to recognize the mixture of positive and negative effects FDI brings to a nation. This research evaluates ways African nations can maximize the effects of FDI and enhance the use of FDI in the development process. The paper is divided into 4 sections. Section 1 introduces the subject of FDI and presents an overview of its flows into Africa. Section 2 evaluates the current situation of FDI in Africa and the measures countries are adopting to increase the inflows of FDI. The risks and dangers that accompany FDI and the maximization of benefits are presented in sections 3 and 4.

INTRODUCTION

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OVERVIEW OF FDI FLOWS

The flow of foreign direct investment to different countries is unequal. The major sources and destinations of FDI have been the United States, the European Union, and Japan. The European Union is currently the largest recipient and source of FDI. The

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largest contributors of FDI in Africa are France and the United Kingdom. Africa has been receiving the lowest share of global FDI despite efforts by African nations to reverse the trend. (World Investment Report, 2001) The small number of investors in the continent is usually attributed to weak economic performance. However, the economic climate has improved over the past few years. The growth of domestic output has been greater than that of the population for the first time in many years.

RECENT FLOWS OF FDI TO AFRICA

The major recipients of FDI in 2000 were Angola, Egypt, Nigeria, South Africa, Tunisia, Ivory Coast, and Mauritius. The targeted industries were generally primary industries, energy (oil and gas), mining, and agriculture, which constituted 60% of the total FDI the continent received. Angola and Nigeria are the main countries when it comes to energy. In the secondary industries (steel and construction), FDI was mainly targeted at South Africa. Telecommunications, financial business services, and tourism are the FDI initiatives aimed at the services sector. (Lodhi, 2002) FDI into Africa declined by more than 13% in 2000. "Although African countries' efforts to improve the investment climate on the continent led to more FDI in 2000 compared to FDI in the 1990s, the UNCTAD report says. that the small share in world FDI declined to less than 1% in 2000. This calls for further efforts to attract FDI into Africa." (ICTSD, 2001) Department of Economics, Finance, Insurance, Risk Management.

During the 1990s a group of African countries attracted larger inflows. Two of the countries increasing inflows were Uganda and the United Republic of Tanzania. They attained record levels of $250 million each in 1997, compared to an inflow of 1 to 3 million in 1991. Morocco is another country that has consistently attracted increasing FDI flows. The increase was due, in part, to the privatization of public enterprises.

A survey by UNCTAD showed a large recovery of FDI inflows during 2002 in seven of eight countries: Cameroon, Cape Verde, Chad, Gambia, Sierra Leone, Zambia and Zimbabwe. This success is attributed to a "combination of policy reforms and an improving global commodities market." The only country failing to register growth was Benin. For three years now, FDI inflows to Benin have fallen. According to UNCTAD, this resulted from a slowdown in the country's privatization program.

Gambia has performed well compared to countries of similar size. FDI inflows reached their peak in 1999-2002, maintaining a level above $35 million. UNCTAD attributes this success to investment in tourism and downstream activities. UNCTAD believed the trend in Gambia would continue because of additional planned reforms.

Another county that has been able to resist this current trend in decline is Uganda: FDI inflows reached a peak of $275 million in 2002, compared to $229 in 2001. The rise in inflows is attributed to the liberalization of the country's telecommunications and manufacturing sectors. Another contribution to the rise in inflows is the admission of African countries to the US market through the African Growth and Opportunity Act.

Measures by Host Countries to Increase FDI in Flows

According to UNCTAD, African countries need to take some measures to increase the inflow of FDI. These measures should be country specific, determined by the country's political and economic situation, as well as progress the country has made in the liberalizing its FDI policies and promotional activities. The following measures were suggested by UNCTAD:

1. Provide a favorable investment climate including political and economic stability. This should be accompanied by private-sector development to ensure the proper functioning of markets and to engage in careful macroeconomic management.
2. Improvement of the FDI climate by simplifying administrative procedures.
3. Promotional efforts and methods targeting particular industries or projects, and evaluating the effectiveness of the work. In addition, UNCTAD suggests that African countries participate in joint efforts to promote FDI. This will strengthen regional integration and joint activities to promote the entire region as a location for investment.
4. Through the creation of a regional market, the continent will become a more attractive market for FDI projects. According to UNCTAD, some initiatives in this particular area are already underway. An example is the signing of a trade protocol by member states of the South African Development Community (SADC) in 1996. SADC is made up of 14 member states, which include South Africa, Angola, Botswana, Democratic Republic of Congo, Lesotho, Malawi, Namibia, Mauritius, Mozambique, Seychelles, Swaziland, Tanzania, Zambia, and Zimbabwe. The aim of the community is to create a free trade area. UNCTAD also favors other efforts for sub-regional integration.

Apart from measures by host countries in promoting FDI, UNCTAD suggests ways home countries of firms, and the international community can improve Africa's prospect as an attractive location for FDI.

Measures by Home Countries to Increase FDI Inflows

There are several ways home countries can increase FDI inflows. These include:

1. Help developing nations to reduce their external debt. The reduction of external debt is vital in creating a favorable climate for both domestic and foreign investors because external debt and FDI are linked through balance of payment difficulties, which increase the difficulties in easing foreign exchange and profit remittance regulations.
2. Make the continent a more viable and attractive location for foreign investment by increasing technical assistance.
3. Facilitate access to developed countries' markets for African products. For instance the U.S. recently initiated tariff reductions for textiles and apparel.
4. Facilitate access to information on investment to potential investors. Many potential investors are ignorant of the investment opportunities in Africa.

Disseminating this information can help investors become familiar with a variety of opportunities

ADVANTAGES AND DISADVANTAGES OF FDI AS A SOURCE OF ECONOMIC GROWTH

According to Rosalie Gardiner, in her paper, " Foreign Direct Investment: A Lead Driver for Sustainable Development?" FDI is simply a source of capital; " the impact of FDI is dependent on what form it takes. This includes the type of FDI, sector, scale, duration and location of business and secondary effects." Gardiner then outlines some positives and negatives of FDI for developing countries. It is important to note that while some countries have experienced growth because of large FDI inflows, other have not. On the other hand, Carkovic and Levine find a lack of positive relationships between FDI and development for a number of countries.

The Possible Benefits of FDI as a Source of Development

FDI can contribute to Gross Domestic Product, Gross Fixed Capital Formation and Balance of Payments. Empirical studies show high GDP and FDI inflows are positively related. However, this positive relationship does not apply to all countries. Other contributions FDI can make to the host country's economy include assisting in debt servicing repayments, stimulating export markets, and producing foreign exchange revenues.

Another aspect of FDI that can serve as a source for economic development is currency stability: " FDI inflows can be less affected by change in national exchange rates as compared to other private sources." Gardiner sees this in currency devaluation, in which relative cost of production and assets decrease for foreign investors and thus increase the attractiveness of investment in these countries. Also, according to UNCTAD, through product diversification, FDI can move into new investments and reduce market dependence on a limited number of sectors or products.

FDI can contribute to social development by increasing employment, and wages and by replacing waning market sectors. This can be achieved as investors generate and expand businesses. Local businesses may also expand as they supply new or increased operations resulting from FDI.

One particular benefit FDI may offer is poverty reduction. Since poverty is related to unemployment, investment is essential for the creation of jobs in the formal economy, with indirect effects on the informal sector. According to UNCTAD, the extent FDI contributes to the social and economic development objectives depends on policies pursued by the countries concerned. This means that the goals and purposes of FDI must correspond with those of the host country. The positive effects of FDI in host countries include increases in employment, development of domestic and export markets, technology inflows and upgrades in domestic industries.

The Negative Aspects of FDI as a Source of Development

High levels of FDI do not necessarily show domestic gain. (UNCTAD, 1999) Other factors may limit the economic gain to the

host economy. Examples of such factors include corporate strategies, and importation of goods and resources used in production. Examples of corporate strategies that may reduce the benefits of FDI include importation of intermediate goods, management fees, royalties, profit repatriation, capital flight and interest payments on loans. However, FDI is most affected by instability.

The gains in employment, wages, and so on, may be realized by a very small part of the population. When this happens, wage differences between income groups will increase and the distribution of income may become unequal. (OECD, 1999) It is also possible that foreign transfer of technology and organizational skills may not to be suitable for the current needs of the local economy. FDI may have a negative impact on local companies who find it difficult to compete for markets and workers. (UNCTAD, 1999).

Another negative effect of FDI as a source of development is what Gardiner terms "crowding out." This is a situation where "parent companies dominate local markets, stifling local competition and entrepreneurship."

How can developing nations maximize the benefits associated with it? The next section looks at how this can be achieved.

MAXIMIZING THE POTENTIAL OF FDI

For African nations to fully maximize the net benefits of FDI, they must identify factors that have made FDI a positive and those that have not. According to a study by Borzenstine, De Gregorio and Lee higher productivity occurs only when host countries meet a certain level of human capital. Better economic performance occurrs in countries with an educated population. Their findings suggest that if African nations improve the educational level of the population, they can improve economic performance as more FDI is drawn into their economies.

Delta Pearl Ltd, works with multinational firms to conduct foreign investment reviews. The aim of the reviews is to "highlight risks areas and to identify how investment can gain efficiencies and finance development at the local and national level of the host economy in order to better distribute the benefits of the investment." According to the organization, some methods needed to achieve the aim are: instituting enhanced backward linkages with the local private sector; partnerships with international organizations; community development and governance projects; market intelligence to reduce information asymmetries; environmental improvements; spillover benefit measurement; enhanced corporate responsibility; and communication programs and specialized staff training.

FDI and Business Linkages

With the increasing importance of investment as a source of development, host countries are seeking not only more FDI, and how these investments can help attain sustainable economic development. UNCTAD suggests that the most important means of gaining FDI is through "production linkages between foreign affiliates and domestic firms."(World Investment Report, 1999) In an article, the organization explains linkages and how host countries can gain the benefits offered by FDI. Linkages can benefit both local enterprises and foreign affiliates. Through linkages, vital

information is distributed throughout the economy, which helps in the "dynamism and competitiveness of the domestic enterprise sector- the bedrock of economic development." Foreign affiliates gain from these linkages by reducing costs and increasing access to both tangible and intangible assets in the local economy.

Because most foreign affiliates possess better skill and knowledge, linkages between foreign affiliates and local enterprises are of greater significance than linkages among domestic firms.

The Use of Linkages in Achieving Growth

Backward linkages occur when foreign affiliates acquire goods or services from domestic firms. Forward linkages occur when foreign affiliates sell goods or services to domestic firms. When broadly defined, linkages take into account non-business entities such as universities, training sectors, research and technology institutes, export promotion agencies and other official or private institutions. (World Investment Report, 1999) In this paper linkages at the business level are addressed focusing on backward linkages between foreign affiliates and domestic forms.

Backward linkages occur when foreign affiliates acquire goods or services from domestic firms, involving "longer term relations between firms." This type of linkage is usually characterized by a continuous exchange of information, technology, skills and other assets. Most spillovers from foreign investments are likely to be in the form of backward linkages.

A number of studies have tested for spillovers through backward linkages. One important study was by Beata Smerznynka, a researcher with the World Bank. Beata first notes that local enterprises might have a limited ability to learn and multinationals may choose to import intermediate products if international technical standards are ahead of local enterprises. This suggests that spillovers from backward linkages are more likely if a reasonable gap exists between domestic and local firms. However, spillovers rarely take place when domestic enterprises are more productive or the gap is non-existent. Beata found that positive spillovers occurred through backward linkages, when the " firm's productivity is positively affected by the sector's intensity of contacts with multinational customers." The results also suggested that firms, which normally gained from backward spillovers from FDI, were those with extensive export experience. This was due to the frequent contacts between the firm and foreign clients.

Backward linkages can benefit both foreign affiliates and local suppliers. Foreign affiliates benefit from sourcing locally. For instance, obtaining low cost labor to reduce production costs, obtaining direct subcontracts with local suppliers to increase flexibility and specialization and adapting technologies and products to local conditions. Although there are few technologically advanced suppliers in a region like Africa, those that are a bit advanced can provide investors with technological and skill, thus enhancing innovation.

There are a variety of benefits that local suppliers can realize from backward linkages. Output and employment may increase. Knowledge and skills may spread between

firms. The strength of these linkages may encourage "production efficiency, productivity growth, technological and managerial capabilities, and market diversification in supplier firms." Domestic firms may become global suppliers or multinationals. The host economy may also gain: the strengthening of suppliers can have indirect effects and spillovers for the economy including mobility of trained labor, enterprise spin –offs and competition effects.

The Importance of Backward Linkages

Despite the disadvantages of backward linkages, these linkages are important for the host economy because: backward linkage helps domestic suppliers by providing opportunities for production and employment and the linkage provides a "direct channel for knowledge diffusion that can assist in upgrading domestic suppliers, technological and other capabilities, with spillover effects on the rest of the economy." (World Investment Report, 2001) Knowledge diffusion is essential for local firms that want to catch up with internationally competitive practices.

The influence of backward linkages on domestic supplier development rests with factors such as the foreign investor's markets, which can create an incentive to establish operations that are internationally competitive, and the capabilities of domestic firms. In cases where capabilities are weak, a small amount of linkage will occur.

CONCLUSION

Since FDI has different contributions to the different countries and to different sectors in the country, a sectoral approach can be used to assess its contributions.Decisions can be made based on the performance of each sector. Based on the sectoral approach, FDI should be restricted if a negative effect is found to be associated with a particular FDI in a particular industry.

Governments should first look at the overall contribution of foreign investors, including trade- offs, before implementing any policy. If for instance, FDI is not contributing much towards the technological goals of the country, it may still be useful because of its contribution towards employment. Governments should know the goals it wants to realize from FDI and target FDI towards that area.

Finally, there will certainly be some discrepancies between the goals of the foreign investors and those of the host government. Since the concerns of the host country may not be similar to those of the investors, there is a need for cooperative planning. Both parties should reach a mutually advantageous agreement for the benefits of FDI to be fully realized in a sustainable manner.

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