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Discussion Paper No. 2001/82

## **Foreign Direct Investment in Emerging Economies**

Lessons from sub-Saharan Africa

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### **Abstract**

This paper analyses prospects for foreign direct investment (FDI) in Africa. The problems with regard to attracting FDI in small economies are not that different than those in larger economies in the developing world. In particular, lack of infrastructure, cumbersome government regulations and restrictions on equity holdings by foreigners are common to both large and small countries. FDI flows could be a lot higher in sub-Saharan Africa if governments implemented a proper set of regulations that enabled investors to do business in a fair and consistent manner. In small countries, a single large project can be very significant in terms of raising interest in FDI. For example, Mozal in Mozambique has given the country greater visibility in the international arena. Also, if a small country is able to successfully implement a large project, it establishes itself as a credible host for FDI, thereby attracting further investment and employment.

Keywords: foreign direct investment, Africa

JEL classification: F21, O19, O55

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## **1 The importance of foreign direct investment: a summary of analytical issues**

Why does foreign direct investment matter to economic development? There are several reasons that foreign direct investment has a significant impact on economic growth; this impact is magnified within a small economy. In particular, foreign direct investment (FDI) impacts five variables—domestic investment, technology, employment generation and labour skills, the environment and export competitiveness. We will summarize these arguments below.

### **1.1 Investment**

There are two competing theories regarding the effect of FDI on domestic investment. One is that FDI encourages domestic investment by providing new markets, demand for inputs and new technology that spills over into the economy. Labour is mobile and often moves from multinational firms to domestic firms; more skilled labour may leave a multinational firm to form a start-up. Researchers also believe that FDI can serve to increase competition thereby making markets (including financial markets) more efficient. Finally, investment in new sectors can stimulate the growth of new industry and new products.

The opposing view is the FDI crowds out domestic investment by being a monopolistic competitor. Domestic firms are simply not able to compete with foreign firms in terms of their advertising power, ability to dominate the market and engage in predatory pricing to prevent entry. Researchers also believe that FDI crowds out domestic investment by raising the demand for money and consequently interest rates as well. Also, if financial inflows are very large, they can raise the rate of exchange, making the country's exports less attractive. However, there is a general consensus in the literature that crowding out is not a major problem with regard to FDI. Rather the benefits of FDI are quite visible in terms of increased competition, efficiency and innovation.

### **1.2 Employment**

There is a general consensus in the literature that FDI has a positive effect on employment. The availability of inexpensive labour is often the main reason that foreign firms choose to enter a country. In addition, the quality of the labour force plays an important role. Countries that are most attractive to foreign firms are those with literate, relatively skilled labour forces. Foreign firms are often dominant sources of employment, generating hundreds, if not thousands, of jobs in the region where they are located. Foreign firms provide jobs in manufacturing plants, mines and services. They also generate employment in firms that are suppliers; these firms may either be local firms or other foreign firms that are attracted to the region because of the market provided by the foreign firm. In the long term, some of this employment generation may be mitigated by layoffs to increase efficiency. But long-term employment generation may also be higher than jobs generated in the short-term if the firm is able to compete in the international marketplace.

Foreign firms are also often significant employers of women. Industries such as textiles and electronics often employ labour that is predominantly female; in some cases, this

percentage of female workers is over 90 per cent. It is also well documented that a significant part of the earnings of female workers are consistently allocated to the nutrition, health and well being of their children. Therefore, the increase in wages from employment by foreign firms often increases nutrition levels, expenditures on healthcare and the quality of life.

The controversy surrounding multinationals rests not on whether or not they generate employment but on working conditions within their factories. There is considerable concern that foreign firms exploit their workers, by stipulating long working hours in very difficult environments. The 'sweatshop' nature of textile firms and other multinational enterprises has led to public outcry and various attempts to monitor working conditions and enforce basic labour standards. Several multinational firms have also made efforts to address this situation.

### **1.3 Technology transfer**

Do foreign firms bring new technology into their host countries? And do they encourage domestic firms to innovate? There are two opposing theories for each of these questions. Most researchers agree that foreign firms do bring new technology into their host countries. Often, this is the best way for the host country to acquire both mature as well as new technology. These technologies have often increased productivity of labour and capital, improved the standardization of the product and reduced error rates in production.

Investment in new technologies by foreign firms has also contributed in many countries to the upgrading of the overall stock of capital. Foreign firms are often the only firms capable of mobilizing the financial resources necessary to bring new technology into the host country. They are also generally more efficient in raising and using financial resources. This is in part because internalized transfers are generally more efficient than arm's-length transactions. They allow firms in the host country to have access to the parent company's technology without the restrictions on accessibility and use that accompany licensing arrangements. Furthermore, they also allow access to 'tacit' knowledge, which can sometimes be more important than codified information. There is plenty of evidence to indicate that technology acquired via foreign direct investment is far better used than technology acquired via licensing or other external arrangements.

On the other side, some researchers argue that technology introduced by foreign firms is often inappropriate for the host country. They argue that foreign technology is often much too capital-intensive, particularly in countries where unemployment runs high. Critics are also vocal about the export of pollution-intensive technologies from developed countries where these technologies are no longer allowed. Finally, it is argued that sometimes, external transactions allow foreign technology to be acquired more cheaply (particularly if the technology is mature).

The second issue that emerges in the literature focuses on the relationship between foreign technology and domestic innovation. After several decades of research, this question also remains open. On the one hand, the theory is that there are technological spillovers from foreign firms into the domestic sector. Spillovers occur through a variety of channels—employees move from foreign firms to local ones, technology is observed and copied by local firms and supporting technologies are developed in

response to demand generated by the foreign firm. Sourcing of inputs also serves as a major stimulus to technological development. Foreign firms often buy inputs from local firms, thereby motivating them to become more efficient and to engage in cost-cutting innovations.

On the other hand, researchers argue that FDI crowds out domestic investment in technology. Large foreign firms prevent domestic firms from innovating, by capturing a large market share and thereby lowering demand for products made by domestic firms, or by cornering the market for high-skilled labour, thereby depriving domestic firms of this resource. It is generally believed that foreign firms by and large do generate some technological development in the host country.

#### **1.4 Environment**

Multinational firms are one of the main foci of environmental groups. These groups have expressed strong concerns about the fact that foreign firms operating in situations where rules are either non-existent or not enforced have greatly exceeded emissions and effluent levels allowed in their home countries. Critics point to areas such as the US-Mexican border, where *maquiladora* firms have polluted the land, water and air to alarming levels. Multinational firms have also been accused of taking advantage of poor and unenforceable rules and of exercising significant political influence to prevent the imposition of rules regarding the environment.

On the other hand, a smaller amount of research shows that multinational firms may introduce cleaner technologies into developing countries to replace old, outdated and pollution-intensive capital equipment. One way of resolving this debate is to look at the stock of FDI in developing countries and do an 'environmental profile'. Are technologies in developing countries more polluting than those in developed countries? Econometric analyses of the 'pollution haven' hypothesis do not confirm this notion, but case studies of individual firms do show that they shifted to environmentally lax countries in order to avoid enforcement of strict laws. However, in general, the cost of enforcement is not high. Multinational firms are driven by labour costs to a much greater extent than environmental laws. Thus, host countries should be encouraged to enforce environmental regulations; all the available evidence indicates that this will not lead to significant shifts in the location of multinational firms.

#### **1.5 Export competitiveness**

Foreign firms often help to increase export competitiveness in the host country. This is accomplished in three ways. Foreign firms often bring in dominant technologies that help to standardize the product, thereby making it suitable for export. Foreign technology also helps to increase production, reduce error rates and improve the quality of the product. All of these facts are helpful in international markets. Foreign firms have a strong advantage when it comes to marketing. Subsidiaries in the host country can often take advantage of a well-established distribution system to market and sell their products. Multinational companies also have better access to trade finance and better transportation and warehousing facilities than their local counterparts. They may also have better access (with lower tariff rates) to developed country markets.

But most importantly, foreign firms bring with them a brand name. This helps to launch a product in international markets, as well as to increase its market share. Foreign firms are usually far more capable than their domestic counterparts of investing in advertising, be present at trade shows and use other promotional methods to raise the visibility of their product in international markets. Thus, FDI has generally had a positive effect on export competitiveness, balance of payments and economic growth.

## **1.6 Majority ownership**

The evidence on FDI increasingly suggests that majority-owned firms perform far better than joint ventures (Ramachandran 1993 and Ramachandran and Shah 1999). Why is it that foreign subsidiaries are superior performers to firms in which each party owns a 50 per cent share? The answer is relatively straightforward and has to do with incentives. The amount of investment made by the owner of a firm is directly related to his/her control over profits. This in turn is determined by the share of equity controlled by the owner. When the foreign firm controls a majority of equity, it invests far more in the subsidiary firm than when it controls 50 per cent or less. This is because majority equity ownership enables greater control over profits (and management) than minority equity or a 50 per cent stake. Thus, the profitability of majority or wholly-owned subsidiaries has consistently been shown to be greater than that of joint ventures.

Why then do joint ventures persist? There are several possible answers to this question. Many governments are afraid of their lack of control over foreign-owned subsidiaries. Some believe that joint ventures will result in greater benefits to the domestic economy, including technological spillovers. Others are concerned about the political and economic influence of large foreign firms. Still, there is enough evidence to suggest that governments should give careful consideration to wholly-owned subsidiaries. In terms of profitability and consequently of investment (including investment in new technology), these firms are far superior to joint ventures.

## **2 Global trends in foreign direct investment**

One of the major forces behind globalization has been the increased participation of developing countries in foreign investment, both as host countries and more recently, as outward investors. Until 1998, the developing country share of global FDI had been increasing annually during the 1990s, reaching 37 per cent in 1998. FDI flows jumped from 0.8 per cent of developing country GDP in 1991 to 2.7 per cent in 1997. Inflows of FDI to developing countries continue to be concentrated in only a few countries. The top five host countries (China, Brazil, Mexico, Singapore and Indonesia) accounted for 55 per cent of FDI inflows to developing countries in 1998 (UNCTAD 1999).

The Asian financial crisis that began in 1997 was one of the main reasons for the decrease in FDI to developing countries the following year. In 1998, developing countries attracted US\$ 166 billion in inflows of FDI, a four per cent decrease from 1997. In addition, economic growth and increased FDI in developed countries during these years pushed the developing country share down. Even though inflows to developing countries increased significantly to US\$ 192 billion in 1999, this does not compare to the growth spurt that took place during the mid-1990s.

Finally, in 1998, less than 1.8 per cent of global FDI was directed at the Least Developed Countries adding up to less than US\$ 3 billion. The 48 countries designated as LDCs by the United Nations are mostly located in Africa. The LDCs hardly participated in the previous growth of the developing country share in overall investment, their percentage adding up to less than 1 per cent of global FDI inflows during most of the last two decades (UNCTAD 1999).

Despite the substantial setbacks that are being experienced from the Asian financial crisis, the Newly Industrializing Economies (NIEs) and Association of Southeast Asian Nations (ASEAN) have completely transformed their economies in a relatively short period of time. The extraordinary success witnessed in this part of the world have spurred other developing countries to follow in their footsteps in the hope of breaking out the sidelines of the global economy and into the ranks of middle income countries. Emphasis in this chapter will be put on the fact that although the highly visible and exciting growth spurts of FDI and GDP growth rates in NIEs and ASEAN countries captured the world's attention they were nurtured by decades of political and economic stability.

## **2.1 South-South foreign direct investment**

A relatively new trend in global investment flows is evident in FDI originating in developing countries. These flows reached roughly 14 per cent of global FDI outflows in 1997, up from 5-7 per cent in the 1980s. Since the majority of these outflows originated in East Asia, the financial crisis in that area led to a reduction of 8 per cent in FDI originating in developing countries in 1998 (UNCTAD 1999).

Not surprisingly, about 80 per cent of this South-South investment originates in a few of the more successful developing economies; Hong Kong, Singapore, Taiwan, China, South Korea, Malaysia, Nigeria, Brazil, Argentina and Chile. By region, 90 per cent of FDI outflows from developing countries came from South, East and South East Asia in 1997. On a stock basis, 90 per cent of these Asian outflows were invested within the region. Intra-ASEAN flows fell sharply after 1997, severely affecting Laos, Cambodia, Vietnam and Myanmar, which are very dependent on inflows from neighbouring countries.

Investment from South, East and Southeast Asia to Latin America and the Caribbean (LAC) has also been increasing during the 1990s (UNCTAD 1999). Of the FDI flowing out of the LAC region, a larger percentage is directed toward developed countries (about half, on a stock basis in the early 1990s). This figure may be skewed by Mexico, which directs more FDI to developed economies to the north than its regional partners. Unfortunately, sub-Saharan Africa has been the least visible in the new South-South FDI trend. The developing countries that do invest in Africa are Asian rather than Latin American.

The majority of developing country FDI outflows are new sources of investment for other developing countries. Possible explanations behind this emerging pattern include the fact the success of some developing countries has increased the differences within the rubric of 'developing countries'. Even though both investor and host are 'developing economies', they are usually heterogeneous in terms of size, level of development, efficiency and technology. Thus, significant comparative advantages can be found in



these differences, provided they are not too large as to be prohibitive (UNCTAD 1999). Other analysts propose that the increase of South-South investment is partly because investors from Asian countries rely less on national trade promotion organizations or support institutions to pave the way into new markets than developed countries do (Bhinda *et al.* 1999). The quantity and success of investment with both origin and destination within ASEAN has been attributed to the fact that investors from neighbouring countries are more amenable to joint ventures with local partners and bring with them more compatible technologies, management styles and products (Chia 2000). Some analysts also contend that Asian investors may have more leeway than developed country investors because their environmental and labour rights practices are not as closely watched by non-governmental organizations (Chia 2000).

## 2.2 Asian FDI flows to sub-Saharan Africa

Of particular interest is the possibility of increasing investment from developing countries to LDCs, most of which are located in Africa, given the reluctance of developed countries to increase and change the nature of their investment on the continent.

Initial outflows from NIEs and ASEAN countries to Africa have indicated that this could be a new source of considerable growth (see Table 1). This paper contends that the changes that need to be made in order to attract East and South East Asian investors to Africa, are the same basic changes that will attract developed country investors as well. However, there is hope that increased activity on the part of Asian investors first could increase growth rates and perhaps incite ‘copy-cat’ behaviour on the part of developed country investors in certain sectors of the more attractive economies in Africa.

Table 1  
Outward FDI flows and stock from selected asian countries to africa  
(millions of dollars)

	China		Malaysia		S. Korea		Taiwan	
	1991	1995	1987	1997	1992	1997	1987	1997
Flows	1.5	9.2	-	94.7	27.3	72.4	1	0
	1990	1995	1987	1997	1987	1997	1987	1997
Stocks	49.2	104.4	-	140.7	11.6	362.8	3.7	97.3

Source: UNCTAD, *World Investment Report*, 1999.

Countries such as China, Malaysia, Hong Kong, Taiwan and South Korea were increasing their activity in SSA until the financial crisis of 1997. Investors from these locations concentrated on the communications and construction industries. Flows rose from virtually nothing to an annual average of US\$ 160 million in 1994-1995 (Bhinda *et al.* 1999). Not surprisingly, most of this Asian investment was directed toward South Africa, but during the late 1990's, companies began to expand into Botswana, Ghana, the Seychelles, Tanzania, Uganda and Zimbabwe (Bhinda *et al.* 1999). Since 1993, South African companies have also increased investments in southern Africa, perhaps helping to bring about this expansion of Asian investment. Neighbouring countries are likewise investing in the new South Africa (Bhinda *et al.* 1999).

The fundamental question here is could foreign direct investment from the NIEs and ASEAN countries create an 'Asian miracle' in Africa? It is helpful to consider the pattern of Asian regional flows during the last few decades. This investment pattern is described in greater detail later in this chapter but essentially, the greater part of the FDI was pushed by external factors and facilitated by favourable domestic characteristics. Asian investment within Asia will continue and the next destinations targeted seem to be the socialist transition countries- China, Vietnam, Laos and Myanmar. Of course, these will not be the only destinations of future FDI. Business associations and governments of Malaysia and Thailand are very actively promoting the consideration of alternative African and Latin American destinations.

Asian investment in Africa will most likely increase but will not provide enough investment to induce the high rates of growth needed to lift LDCs out of poverty. In addition, the Asian financial crises created significant corporate debt and the financial restructuring in those countries will be an arduous and lengthy process. Little is known about Africa in East and Southeast Asia. Extraordinary efforts in promotion will be needed to increase knowledge of opportunities and business conditions of specific regions and countries.

As will be discussed in later sections, the changes that are required to increase East Asian and Southeast Asian investment are the same improvements that are needed to increase FDI from any country. Perhaps East and Southeast Asian investment will jump start investment from other areas of the world and increase the visibility and improve the overall image of Africa.

### **2.3 Foreign direct investment in Southeast Asia**

The success of ASEAN countries in the last two decades has encouraged other developing countries into attempting to fuel economic growth with export-led foreign investment.

Many African countries today have similar economic situations to Southeast Asia in the 1960s (Lindauer and Roemer 1994). In general the similarities lie in the significant natural resources, colonial legacies inherent in political and economic structures and the great need for human capacity building. For this reason, it seems there is some basis for comparison and application of lessons learned (Court and Yanagihara 1999).

The Association of Southeast Asian Nations (ASEAN) was created in 1967 by Indonesia, Malaysia, Thailand, Singapore and the Philippines. By 1998, these five

members were joined by Laos, Cambodia, Vietnam, Myanmar and Brunei. During the late 1980s investment from Japan and the Newly Industrialized Economies, (NIEs) Taiwan, Hong Kong, South Korea and Singapore, rushed into the 'second tier' countries of Southeast Asia, namely Thailand, Malaysia, Indonesia and the Philippines. This second cascading of investment into ASEAN is what it is hoped could be replicated in Africa in order to increase its participation in the global economy, either by the NIEs or the faster growing initial members of ASEAN (Thailand, Malaysia and Indonesia).

A large part of the growth of ASEAN-hosted FDI took place in the electronics exporting sector, as NIE firms searched for lower labour costs, relatively depreciated currencies and greater access to OECD markets (Thomsen 1999; Lim and Sidall 1997). In 1985, the yen appreciated sharply and set off a world wide realignment of currencies, reducing the competitiveness of NIE exporters. In addition, the cost of labour in the NIEs was continually rising. At the same time, developed countries began increasing protective measures against cheap imports from the NIEs.

All of these external factors pushed the NIEs to search for new export platforms. ASEAN countries (mainly Malaysia, Thailand and Indonesia), were chosen because of their internal characteristics. Most importantly, there had been relative political and macroeconomic stability in these countries during the last three decades, (the Philippines being a notable exception). Together the countries also formed a large potential market for import-substituting investment. All types of investors were attracted by the relatively liberal investment regimes and literate, productive and cheaper labour found in ASEAN countries. The ASEAN countries were also chosen because of geographical proximity and cultural similarity, as well as the fact that some NIE companies had past successful investment experiences to which they could refer.

Overall, Southeast Asian growth was export-led by industries such as electronics but the individual development of countries differ. Electronics figured prominently in Malaysia and Thailand manufacturing investments. In Thailand, manufacturing was only one third of FDI inflows, with a large share going to distribution and finance as well as construction and real estate. Indonesian investments were generally resource-based: oil and gas, chemicals and paper. Investment in Philippines is quite diversified. In both Indonesia and Philippines, the electronics sector is growing (Thomsen 1999).

Domestic conditions in ASEAN countries had not always been favourable to an influx of FDI. Perceptions of FDI included concerns that it could crowd out domestic investment, that it could be divorced from the domestic economy and increase income inequality, that overgenerous fiscal and financial incentives and subsidies could negatively impact government revenue and that foreign companies would not pay attention to environmental effects. However, resistance to the negative effects of FDI was weakened during the mid 1980s in order to take advantage of the external conditions (Chia 2000).

The Asian financial crisis seriously undermined investor confidence in ASEAN countries. Governments need to realign macroeconomic indicators, improve public and financial market governance and effectively enforce business laws. In addition, the political turmoil in Indonesia following the crisis is negatively affecting the investment in that country as well as the investor image of the region as a whole. International Monetary Fund-backed economic reform plans and competition from China are pushing countries to further liberalize trade and investment policies. The crises showed that FDI

is much less volatile than short-term investment and is thus very desirable for developing countries. However, although there was not disinvestment on the same scale as the pull-out of short-term capital, the crisis did negatively impact the inflow of FDI into ASEAN countries. The financial uncertainties, corporate debt and shrinking markets impinged on the inflow of FDI during the years following 1997 (Chia 2000).

## **2.4 A Comparison of FDI flows into Asia and Africa**

The surge of investment into ASEAN countries in the late 1980s was largely due to a convergence of specific external circumstances and desirable domestic characteristics such as stable political structures, good macroeconomic figures, relatively liberal investment policies, and literate, productive workforces.

Foreign direct investment in Africa has largely been in the area of natural resources, namely oil and mineral extraction, in the countries that possess these resources: Nigeria, Angola, Botswana, South Africa. Significant reforms in macroeconomic policy and liberalization of trade and investment policies have taken place during the 1980s, yet African countries have yet to reap the rewards. Clearly, more has to be done to reverse the decades of bad reputation in the minds of investors.

At the root of the matter is the question—how can African countries link to the global economy and reap some of the benefits of the extraordinary growth in international economic activity? African governments have acknowledged the failure of command economies in pulling their countries from poverty. Yet the experience of the NIEs and ASEAN countries presents an alternative hybrid of market principles and some forms of protection. This creative adaptation coupled with the extraordinary growth of these economies from relatively the same level as many African countries has drawn attention to these countries as models. Of course the danger lies in copying these models verbatim.

The fundamental questions are—how do African countries identify and take advantage of their comparative advantage in the global economy and what mix of economic policies will attract investment while at the same time reap the greatest reward for host countries.

## **2.5 Comparative advantage**

At the moment, the general consensus of investors is that Africa's comparative advantage lies in natural resources, not just the extraction of such but in primary processing as well. Of course, domestic resources differ greatly from one country to another. However, to take an example from Asia, Indonesia grew for a decade based on foreign investments in oil and gas and slowly, with investments in infrastructure and human capital, FDI began to diversify into the manufacturing sector. More research is needed to compare the experience of Indonesia to those of the similar economies in Africa like Nigeria and Botswana.

But what of the numerous small African economies without resources such as oil or diamonds? There are still many untapped opportunities in labour-intensive primary processing industries. The barriers faced by investors and policies to reduce them are discussed below. A useful model for similar countries in Africa may be Singapore, a

city-state lacking natural resources which skipped the resource-based manufacturing that took place in other ASEAN countries during the colonial period. Singapore pursued investments in export-oriented manufacturing from multinational corporations as early as the 1960s with very liberal investment and trade policies. Singapore's experience shows how an extraordinarily committed government was able to 'create' national assets and comparative advantage. A significant difference is that the educational level of Singapore was higher at independence than it currently is in many African countries (Chia 2000).

In addition, instead of mandating that investors hire locally, Singapore invested in basic and advanced public education and professional training programmes. In this 'supply-side' approach, the increase in the supply of local skilled labour and managerial and executive staff meant that foreign companies voluntarily sought out local employees to take advantage of assets such as language and cultural familiarity. Other created assets that attract FDI to Singapore are competent, non-corrupt government agencies, a transparent and well-established legal framework, sound macroeconomic management, excellent physical and financial infrastructure and liberal trade and investment policies. The inherent advantages of Singapore were a favourable geographic location and a fairly cohesive society. The creation of comparative advantage was only possible due to strongly committed and competent political leadership (Chia 2000).

The explosive growth in ASEAN has largely been in the electronics exporting sector. Industry analysts have not seen much interest in electronics export manufacturing in Africa. Experts contend that apparel and textile manufacturing seem much more promising for certain countries. The global electronics industry is extremely competitive. Success in this industry requires not just the technological know-how but also exceptional organizational expertise, supplier and customer networks and market knowledge and information (McMillan *et al.* 1999). While the apparel industry seems a more likely source of FDI for Africa, based on the low cost of labour, decisions on where to invest in the apparel industry are not based solely on that criterion. While production costs in sub-Saharan Africa are lower, longer and less reliable delivery times as well as lower quality of product are not compensated for. However, production and labour costs are on the rise in Asia and a small number of firms are beginning to explore the cost potential of manufacturing in Africa (McMillan *et al.* 1999).

## **2.6 Policies for promoting investment**

ASEAN countries have some of the same concerns as African countries regarding the impact of FDI on their economies. ASEAN trade and investment policies are a 'mixture of investment incentives on the one hand and restrictions, regulations and performance requirements on the other' (Chia 2000). The main point is that it is the net result of this mixture that companies consider when deciding where to locate manufacturing. ASEAN countries have found that they need to continuously decrease regulations and restrictions in order to attract FDI, especially since the Asian financial crisis. In addition, regional and global trade and investment agreements are moving in this direction. The World Trade Organization's Trade-related Investment Measures (TRIMS) agreement phases out the use of local content requirements.

Much has been written on lessons for Africa from the experience of Southeast Asia. Even though the external 'push' factors may have instigated the surge in investment

flowing into ASEAN countries, it would not have taken place if domestic reforms and stability had been absent. The lesson for Africa is that external conditions are unpredictable however, countries can only take advantage of favourable situations that arise if fundamental investor concerns have been addressed ahead of time. Of course, no country will ever resolve all investor concerns, however, it seems that a minimum level of satisfaction is required in several issue areas. Unquestionably, the necessary but not sufficient conditions for investment in any part of the world are political stability and constant favourable macroeconomic indices. The examination of ASEAN experiences attracting FDI points out a number of other areas of emphasis.

If linkages to the domestic economy are valued, investment policies should not promote one type of FDI over another. In Southeast Asia, the partial openness of policies has led to fewer benefits from FDI such as technology transfer and industrial upgrading. For example, the promotion of exporters who are very dependent on imported materials has decreased the opportunities for backward linkages to the host economy. Export promotion was super-imposed on the pre-established structure that promoted domestic import-substituting industries. A more balanced and equal approach to investors will mean reaping the benefits of different kinds of investments (Thomsen 1999).

The improvement of education levels in Africa, at both primary and advanced levels is extremely important. The ASEAN economies were able to shift into higher value added manufacturing due to the supply of skilled workers. As mentioned before, the cost of labour is only one factor in investor decision-making; productivity and education level are just as important. Long-term broad-based growth relies principally on the increase of existing indigenous capabilities. Not only is education needed to supply employees for foreign investors, but the beneficial links to these foreign companies will be more easily obtained by educated indigenous entrepreneurs.

The lack of domestic savings in Africa means that foreign direct investment will be the quickest way to stimulate significant growth in African countries. A key difference between Southeast Asia and Africa is the amount of domestic savings -Africa having generally half of Southeast Asian savings to GDP ratio. In addition, a large part of the fuel for growth in some of these countries has been domestic investment. In Thailand, for example, Thai corporate investment was twelve times that of foreign investment (Court and Yanagihara 1999).

During 1995-98 15 per cent of FDI flows into the ASEAN region came from neighbouring countries. It seems very unlikely anything on the scale of the 'flying geese' pattern of manufacturing investment that cascaded from Japan to the NIEs to ASEAN could be replicated in Africa. Intra-ASEAN investment in Cambodia, Laos, Myanmar and Vietnam are the most important sources of investment for these less developed countries. While Asian investors are increasing their activities in Africa, much needs to be done before these investors choose Africa over their own neighbours.

South Africa could be a similar engine of growth and investment in Southern Africa. Namibia, Botswana and Mozambique are already some of the fastest growing economies on the continent, in great measure due to investments by South Africa. These investments are largely resource-based and while they do add greatly to GNP, there needs to be an increase in the type of investment that will create linkages with the domestic economy. If all of the above factors are successfully addressed within the 12 SADC countries this investment diversification is more likely to take place.

The proliferation of possible investment locations in developing countries within the last few decades means that competition is fierce. Promotion of existing investment opportunities within Africa needs to be vigorous yet promotion materials must include realistic assessments of the country's assets (Chia 2000).

The Asian Financial Crisis has brought to the forefront the importance of good governance in public and financial sectors. The relevant institutions will take a long time to improve but will contribute to the long-run health of these economies. The post crisis efforts to increase FDI in ASEAN countries has not met with extraordinary success. The negative image of political and economic instability will be difficult to reverse.

As the ASEAN experience shows, there is no short cut to attracting FDI in high value-added manufacturing which brings about the impressive growth rates witnessed in the NIEs and ASEAN countries. It is imperative that the policy makers, academics, union and business leaders of each African country build a consensus on how to take advantage of their existing resources and how to create new assets in order to attract foreign direct investment that will stimulate the growth of the entire economy.

### **3 Additional constraints to investment in Africa**

There are several reasons for low investment in the private sector. Sub-Saharan Africa continues to suffer from high trade barriers, both internal and to some extent, external. It is estimated that domestic trade barriers cost the region as much as US\$ 11 billion per year until recently (Madavo and Sarbib 1997). These barriers have had a significant impact on investment; during the first half of the 1990s, sub-Saharan Africa received only about 1.6 per cent of total international private capital flows.

Macroeconomic reforms in many countries have often been implemented slowly and with difficulty. Government control over interest rates, over-regulation of markets and corrupt, burdensome tax regimes have taken their toll in Africa. Due to these problems, foreign direct investment flows to sub-Saharan Africa for the late 1990s have lagged behind other developing regions. Only Nigeria has received more than a billion dollars of FDI in sub-Saharan Africa. The enormous expansion in global flows of money has largely bypassed Africa. Total inflows of FDI in 1996 were over US\$ 349 billion, of which Africa's share was just over US\$ 5 billion or 1.4 per cent (Sachs and Sievers 1998). This share declined to 1.2 per cent for 1997 (UNCTAD 1999). Meanwhile, developing economies as a whole received 37.2 per cent of FDI, with Asia getting 21.7 per cent and Latin America and the Caribbean getting 14 per cent in 1997. Table 2 describes the value of FDI flows to Africa in 1998.

Table 2  
Foreign investment flows to sub-Saharan Africa, 1998

Country	FDI (m\$)
Mauritius	21
Tunisia	370
Botswana	23
Namibia	52
Morocco	400
Egypt	740
South Africa	330
Swaziland	67
Ghana	255
Lesotho	17
Côte d'Ivoire	21
Zambia	58
Kenya	37
Uganda	135
Burkina Faso	3
Tanzania	190
Ethiopia	5
Mozambique	29
Cameroon	35
Zimbabwe	47
Malawi	17
Nigeria	1720
Angola	290

Source: World Economic Forum, Africa Competitiveness Report 1998.

Researchers highlight other problems as well. In a very interesting analysis of investment flows into Africa, Bennell argues that a careful look at the numbers often reveal that actual investment flows are far lower than *approved* investment projects reported by government ministries (Bennell 1997). Often, only 20-30 per cent of these projects are actually implemented within 3-4 years of initial approval. There are also problems with poor data quality. Also, the three main components of foreign direct investment (direct investment, reinvestment and loans) are often not consistently reported over time, making FDI data from African countries hard to use.

In general, investor response to economic liberalization has been limited as well. UNCTAD's *World Investment Report 1999* argues that although macroeconomic reforms bode well for the region, they have not resulted in increased investment. It appears that investors are waiting to see if the reform process is sustainable. The key



questions are—will the reforms hold through hard times? Can investors be confident that government policies and regulations surrounding investment will remain the same? What will happen to the reform process when governments change hands? Some researchers argue that investment flows will very much depend on the success in ending military conflict and the establishment of stable democracies (Bennell 1997). It is clear that on the whole, investors have adopted a ‘wait and see’ attitude with regard to Africa.

Incentive packages to attract foreign investment have also had limited success, largely due to the reasons described above. Macroeconomic policy reform to promote a stable environment and to strengthen underlying institutional weaknesses including corruption are crucial to the success of these packages. Risk management strategies to reduce the perceived possibility of future policy reversals are also very important. African economies may have to do something to combat the ‘neighbourhood effect’ where investors confuse events in neighbouring African countries. Investors may also use a country's past performance to judge it, thereby ignoring recent reforms and making them difficult to sustain in the face of political opposition.

Finally, there is the issue of domestic investment and the reacquisition of expatriated capital. Many of the pre-conditions that are necessary to attract foreign investment are necessary to increase African resources in the private sector. According to Crocker and Taylor, sub-Saharan Africa has the lowest *domestic* investment level of all developing areas (Crocker and Taylor 1999). African investment is about 16-17 per cent of GDP and is not growing significantly. Many African investors look to international markets for their investments. Capital flight remains a serious problem in Africa, perhaps more serious than anywhere else in the world. It is estimated that in 1990, about 39 per cent of African-owned wealth was being held outside the region versus just 10 per cent in Latin America and 6 per cent in Asia (Crocker and Taylor 1999). These numbers translate into capital flight per worker of US\$ 683 per year and a total stock of US\$ 150 billion being held outside Africa. Crocker and Taylor argue that a complete repatriation would increase capital stock in Africa by 64 per cent! Various measures such as tax reform, anti-corruption measures, new forms of financial instruments, amnesties and better exchange rate management need to be in place to address this problem.

There are some positive signs. During the latter half of the 1990s, the *magnitude* of investment flows has increased somewhat, from US\$ 1 billion per year in the early 1990s to almost US\$ 12 billion in 1996. African governments have embarked on ambitious plans of privatization and macroeconomic reform in order to attract foreign investment. There have also been important developments in African capital markets over the last few years. Financial markets have played a crucial role in increasing the efficiency with which capital is allocated. Fifteen African countries have stock markets and several other countries are in process of building equity markets.

Some researchers argue that Africa does not have the initial conditions to ensure the success of foreign firms or even large local firms in the industrial sector and that the main emphasis of an industrialization strategy should be on the development of industrial firms owned and managed by Africans (Stewart *et al.* 1992). Another common criticism is that multinationals are too capital intensive. Analysis of available data shows that firms with foreign equity are more capital intensive than their local counterparts in sub-Saharan Africa (Ramachandran and Shah 1999). However, these reasons are not good enough to discredit the importance of foreign investment. There is a large literature on the role of foreign investment that describes a variety of benefits

including new management skills, quality standards, new methods of worker training and new markets for export (UNCTAD 1999). Also, technological development is driven by foreign investment; alternative means of technological upgrading are not as effective (Ramachandran 1993).

Foreign investment in Africa thus far has been heavily concentrated in the agriculture and mining sectors. While these sectors have attracted significant amounts of FDI, they have largely failed to establish domestic production linkages and technological spillovers. The main challenge so far has been how to capture rents from the exploitation of natural resources, how to avoid problems with Dutch disease and how to invest financial resources in non-traditional export sectors. The best investment opportunities in these sectors are found not on the stock exchanges, but through direct project financing in many of the resource-based sectors, as well as through privatizations and infrastructure development. As companies in these sectors grow in size and scope, the volume and liquidity in local stock exchanges will rise.

In a survey of foreign-owned firms in Africa, Sachs and Sievers find that the greatest concern of firm-owners is stability, both political and economic. Cumbersome tax regulations, inadequate supplies of infrastructure and corruption are also factors listed by foreign businesses. Tariff and non-tariff restrictions prevalent in Africa can substantially raise the cost of FDI to the host country. Table 3 describes tariff and non-tariff restrictions present in Africa in 1998.

Table 3  
Trade restrictions in Africa, 1998

Country	Un-weighted tariff rates		Un-weighted non-tariff restrictions	
	1984-87	1991-93	1984-87	1991-93
Côte d'Ivoire	23.3	N/A	6.6	N/A
Egypt	42.8	33.5	32.9	45.2
Ethiopia	29.0	29.6	N/A	22.5
Ghana	29.6	N/A	48.4	N/A
Kenya*	39.2	43.7	67.3	37.8
Malawi*	16.7	15.2	96.1	91.3
Mauritius*	34.9	27.6	N/A	35.2
Morocco	23.5	22.8	27.6	N/A
Nigeria	23.8	32.8	17.0	8.8
Tunisia	24.0	27.5	76.2	32.7
Tanzania*	32.1	29.8	62.2	79.7
Zimbabwe*	8.7	10.1	2.5	93.6
<i>All Africa</i>	26.3	25.7	43.7	42.9
Sub-Saharan	26.3	25.3	44.0	47.1
<i>Latin America</i>	26.6	12.3	30.2	8.6
<i>South Asia</i>	61.7	47.5	47.6	20.4
<i>East Asia</i>	17.9	16.7	21.2	3.6
<b>All countries</b>	<b>27.0</b>	<b>22.1</b>	<b>37.7</b>	<b>23.7</b>

Source: World Economic Forum, 1998 and UNCTAD, 1999

Note: \* denotes countries for which data are for 1984-87 and 1988-90.

Recently, a great deal of attention has been focused on the promotion of joint ventures in Africa. Econometric evidence indicates that joint ventures may not be the best way to go. Using a World Bank data set of 200 firms from Kenya, Ghana and Zimbabwe, analysis shows that value added per worker increases with the share of foreign ownership in the firm (Ramachandran and Shah 1999). Firms with 100 per cent foreign equity have the highest value-added in Zimbabwe and Ghana. Kenyan firms that are majority foreign-owned have significantly higher value added per worker than firms that are locally owned or minority foreign-owned. The World Bank data reveals that firms with foreign ownership are generally larger, which is not surprising. Foreign firms invest in worker training programmes to a greater extent than locally owned firms and worker-training programmes are more prevalent in firms which have majority foreign ownership in Ghana and Zimbabwe. Firms with foreign ownership tend to have better trained managers, although this difference is particularly noticeable between wholly locally-owned firms and firms with any degree of foreign ownership. Locally owned firms are concentrated in the textile and garment industry, whereas firms with a higher share of foreign equity are dispersed to a greater extent across food, metal-working and textiles.

The results indicate that majority foreign ownership of greater than 55 per cent raises the value added of the firm; a lesser degree of participation is not significant in terms of its effect on value added (Ramachandran and Shah 1999). Interestingly, a 50-50 split in equity between local and foreign firm does not raise value added significantly. What seems to matter is *clear* majority ownership by the foreign owner. Majority ownership by local owners does not significantly contribute to the value added of the firm.

There may be several explanations for this result. Foreign ownership may bring with it many benefits that local ownership cannot provide; examples include the 'know-why' surrounding know-how, timely access to inputs, finance, maintenance personnel and sources of information about technology and markets. Another explanation is that amongst these benefits are often *intangible* benefits relating to differences in the *quality* of labour and capital between local and foreign firms, as well as differences in the type of training received within these firms. These differences are very difficult to measure but are often highly correlated with ownership and consequently with value added of the firm. This indicates not unsurprisingly, that even though locally-owned firms have control over profits, they may lack access to technology, skills and markets that would help them raise value added. A third possible explanation of our result is that foreign firms are able to exercise market power that results in a higher value of sales. It could be argued that multinational subsidiaries invest more in R&D, advertising and other measures that raise barriers to entry. The results raise concern about promoting joint ventures in Africa. It may be far more beneficial to allow foreign companies to be majority-owned or wholly-owned subsidiaries of the parent corporation.

#### **4 Country evidence from sub-Saharan Africa**

Ghana and Mozambique are two interesting cases from sub-Saharan Africa. Their recent experiences with regard to foreign direct investment are described below.

## 4.1 Mozambique

Mozambique's investment potential rests largely in the area known as The Maputo Corridor. This strip of land links the port at Maputo with Gauteng Province in South Africa. Maputo's port is closer to Johannesburg and Pretoria than any in South Africa. Prior to the start of Mozambique's civil war in 1975, about 40 per cent of exports from Johannesburg and Pretoria were routed through Maputo. The project to renew trade and investment in this area was launched in 1995, the year after both countries held their first democratic elections.

A private consortium has begun work on the toll road that forms the spine of the corridor. Trans Africa concessions, South African companies Basil Read & Stocks and the French construction group Bouygues is constructing a 440 km, R1.8 toll road between Witbank (at the edge of the Gauteng region which includes Johannesburg and Pretoria) and Maputo, which opened in mid-1998. But there have been many problems as well. Talks between CFM, Mozambique's state-owned ports and railway system and the South African-owned railway company Spoornet have broken down over the 15-year concession to manage, operate and rehabilitate the line between Maputo and South Africa. Analysts have estimated that if the Mozambican line were rehabilitated, it could increase its carrying capacity by a factor of five or six. Talks were called off by CFM with a possibility of future resumption. The two entities disagreed over the obligation of Spoornet to pay a substantial fixed fee as well as a percentage of the annual profit. Another company—Mersyside Docks—would not agree to sign a deal on the port until the rail link to South Africa was confirmed.

Privatization of the port and railways in Mozambique has been slow, causing delays in the launch of the Maputo Corridor (*Financial Times* Survey 18/10/99). The World Bank agreed to lend US\$ 100 million to upgrade the three major port-railway systems along the Maputo, Beira and Nacala corridors. The government will privatize operations and management as part of the deal (*AFX Europe* 15/10/99). The corridor's proponents say that 180 separate investments worth US\$ 7 billion with the potential to create 35,000 jobs are in the pipeline. The key investments are the Mozal and MISP projects described below with additional investments in agriculture, (irrigations schemes) and tourism including game parks and casinos.

The Deputy CEO of the Maputo Corridor Company (which groups government agencies from both sides), reports that investments worth as much as R45 billion, (around US\$ 6.5 billion) mostly from the private sector have flowed into northern South Africa, Swaziland and southern Mozambique over the past few years, the bulk of which (R36 billion, or approximately US\$ 5.5 billion) has flowed into the Maputo Corridor. He attributes the investment as being driven by two very large projects—Mozal and a project by Enron. Many of the investments are in tourism and agriculture. Issues to be addressed include the future of the border post and the concessions on the Maputo port and the Mozambican railroad (*Business Day* 26/10/99). A twenty-four hour one-stop border post is planned to reduce the cost of doing business along the Corridor.

The lynchpin of the Maputo Corridor is Mozal's US\$ 1.34 billion aluminum smelting plant, whose major investors are Billiton, a London-listed natural resources group (47 per cent of the equity), Japan's Mitsubishi (25 per cent), South Africa's Industrial Development Corporation (24 per cent) and the Mozambican government (4 per cent in preference shares). Export credit agencies and the International Finance Corporation are

additional sources of finance. Incentives given to Mozal include 1 per cent of its turnover in tax, fixed in perpetuity. In addition to incentives, Mozal has benefited from cheap and plentiful supplies of electric power. These factors, in addition to the relatively low price of alumina, are the primary considerations in the decision to build a very large-scale aluminum plant.

An analysis of Mozal by the Foreign Investment Advisory Service of the World Bank Group concludes that the project provides a model for future negotiations of large projects, solutions to various bureaucratic barriers and the identification of knowledgeable and influential government officials in Mozambique to whom future investors may turn (Wells *et al.* 2000). The premise underlying the government's extraordinary commitment to making this project take off was the belief that a small number of 'mega-projects' would demonstrate to other investors that Mozambique was a good place to do business. It is also believed that these investments will support medium and small-scale local firms and will expand the informal sector. President Chissano has stated that Mozal will serve as a catalyst because it is an example which the whole world can see and therefore believe that it is possible to venture large sums in Mozambique (*Financial Times* 19/10/99). The Mozambican government has begun sending potential new investors to the company so these investors may hear first hand of the Mozal experience.

It is too early to tell how much secondary domestic investment this project will spur, since the project only began a few months ago. However, there are some initial indications. Efforts are being made by Mozal to contract business with small and medium scale suppliers and contractors. Mozal will be spending US\$ 50m on infrastructure such as roads and a dedicated quay in an estuary, Matola, a few kilometers from the port of Maputo. The company and the government are seeking ways to contract with local industry here as well (*Financial Times* Survey 18/10/99). Mozal is holding off on its decision to double production until the port at Matola is made more efficient and the facilities are privatized and upgraded. A proposed management deal for Mersey Docks of the UK has been delayed for more than a year. In the short term, alumina will be shipped from Australia to Billiton's plant at Richards Bay, South Africa, before arriving with a lighter load to Maputo, which has a relatively shallow port.

Another project with significant potential is the Maputo Iron and Steel Project (MISP). The U.S.-based Enron, South Africa's Industrial Development Corporation (a self-financing company acting on behalf of the government) and other partners are planning to build a new US\$ 2.4 billion steel plant which will export 3.5 million tons of slab a year, bringing in an estimated US\$ 700 million in revenues per year. Enron, in partnership with the state-owned ENH, plans to develop a natural gas field in Pande, north east of Maputo and build a pipeline to supply gas to the new plant. Iron ore and electricity will be imported from South Africa for this project. Negotiations on sites, contracts and financing are yet to be completed. Iron ore (magnetite) for the plant—a by-product of copper mining—will be imported from the South African town of Phalaborwa which is about 350 km from Maputo. Construction will not begin until at least 2002 and will last three years. Enron says that operations should begin in 2004, but this is difficult to predict (*Financial Times* Survey 18/10/99).

The pursuit of the MISP project also has a lot to do with the low cost of electricity in Mozambique. In 1998 talks were under way with the Electricidade de Mocambique (Ed M) and the South African utility, Eskom, which supplies some of the world

cheapest electricity, to sign a 850 megawatt supply contract (*Financial Times* 28/6/98). The economic impact of Mozal and MISP is enormous and could stimulate growth in the region. According to some estimates, MISP alone could increase Mozambique's GDP by up to 8 per cent. South Africa is also estimated to benefit from this investment. MISP says its project will provide five thousand jobs during construction and 1,000 during operations (*Financial Times Survey*, 18/10/99).

There is a serious skills shortage in Mozambique, with a low adult literacy rate of 45 per cent, compared to 59 per cent for sub Saharan Africa. The school enrollment rate of 25 per cent is one of the world's lowest. However, domestic investors seem less concerned with skills shortage than foreign investors. This is partly due to the lower technological requirements of domestic industry and explains why domestic industries are less competitive than their foreign counterparts (*Financial Times Survey* 18/10/99). In general, there is consensus in the literature that foreign firms are more efficient than local ones, producing standardized goods on a larger scale.

In Mozambique, labour productivity is low because of inadequate investment in education and worker training. The number of skilled technicians and managers decreased considerably with the flight of Portuguese workers at independence. However, large projects like Mozal have been useful in building worker skills. At the height of construction, Mozal had 9000 workers, of whom 70 per cent were Mozambican. More than 5000 workers will have been trained in basic building skills when construction is finished. When the plant opens later this year it will employ 800 workers, of whom 700 will be Mozambican. The Maputo corridor's proponents claim the potential to create up to 35, 000 jobs in the area once it takes off (*The Independent* 10/11/99).

There has been some criticism of Mozal's use of labour and equipment from outside Mozambique during construction. But local contractors have not capable of using the available machinery at sufficient speed (*The Independent* 29/9/99). As the project moves along, workers within the country will acquire important skills necessary for future construction projects.

South Africa and Mozambique have made job creation and training prerequisites for any contract to which they are a party. Also, all contracts relating to concessions involving state assets, or in which the state had a role, contained a defined minimum value of the contract to be given to 'emerging' contractors. Further strategies to support medium, small and micro-enterprises include the establishment of a regional fund to assist emerging small businesses. There is some evidence to suggest that these policies have paid off. By mid-1998, about US\$ 3 billion had been committed and 12,000 jobs created in the Maputo Corridor (*Financial Times* 28/6/98). Also, a World Bank study finds that investment in the Corridor has resulted in an increase in labour productivity by 30 per cent between 1992 and 1997, with clothing and textiles leading the way.

Mozambique's export competitiveness looks promising as well. Mozal will be contributing to exports in 2001 through the production and export of 250,000 tons of aluminum, or 1 per cent of worldwide production. It will be the second lowest-cost producer in the world according to its proponents, due to low cost of electricity, alumina and taxes. The Mozambique model is strikingly different from others in sub-Saharan Africa. It is a case study of globalization and regionalization at work. Mozambique's future prosperity will continue to depend to a significant extent on its ability to exploit

its competitive advantage by delivering low-cost electricity and providing its neighbours access to its ports.

Mozal's record on the environment is reportedly quite good as well. It uses technology that is as state of the art in environmental friendliness as that available in industrialized countries (*The Independent* 10/11/99). The Maputo Iron and Steel plant may build a slurry pipeline to bring in iron ore from South Africa which would have to skirt around Kruger National Park. South Africa's strong environmental lobby was successful in preventing the pipeline from cutting through the park. The water needed to create the slurry for the pipeline would be drained from the Olifants river, another sore point for the environmental lobby. Alternatively, the magnetite could be carried by rail by Spoornet, South Africa's national railway (*Financial Times* 28/6/98).

Development agencies in Maputo believe that the economy can quickly recover from the recent floods in the spring of 2000, especially if the transport infrastructure is repaired in a timely manner and farmers are provided with food until the next harvest. Flood stricken areas are among the least populated and fertile in the country (*Financial Times* 7/3/00). Mozal and the Maputo Corridor have largely escaped the floods that recently damaged many other parts of the country. In general, investment prospects are good in this region. Large projects like Mozal and MISP have created the momentum for investment and employment generation.

## 4.2 Ghana

Ghana is another relatively attractive country for foreign investors in sub-Saharan Africa. Efforts to attract foreign direct investment in Ghana were significantly increased when the government passed the 1994 Ghana Investment Promotion Act, creating incentives and reducing obstacles to FDI. The programme lifted foreign exchange controls, liberalized trade controls, established a stock exchange and began the privatization process of more than 200 state-owned companies.

Since the establishment of the Ghana Investment Promotion Centre the same year, the office has registered 972 projects mainly in the service, manufacturing, tourism, building and construction and agriculture sectors (Ghana Investment Promotion Centre, *Statistics on Registered Projects, Fourth Quarter* 1999). Approximately one third of these projects are wholly-owned foreign investments, the rest being joint ventures. The leading foreign investors were the United Kingdom and China followed by India, the United States, Germany, Lebanon, Korea, Netherlands and others.

The government is aiming for Ghana to become a middle-income country by the year 2020, requiring a growth rate of at least 8 per cent per year. This growth rate depends to a great extent on investment in the private sector. An increase in private investment from 4 per cent of GDP to 20 per cent is necessary to achieve an 8 per cent growth rate; much of this investment will have to come from foreign countries (*Financial Times* 21/6/98). In 1999, GDP grew at 4.6 per cent, one percentage point below forecast but higher than the 4.2 per cent growth rate of 1997 (*Financial Times* 4/11/99).

The government believes there is potential for private investment in manufacturing, clothing, wood products, agro-industry etc. However, the Association of Ghanaian Industries believes that the economy is too small to attract FDI in these areas and that

there are serious obstacles to investment, most notably unreliable electricity and high interest rates (*Financial Times* 21/6/98).

In general there has been little foreign interest in sectors outside of mining and energy. Since the restructuring of the mining sector with a new code creating an attractive legislative and fiscal environment for mining in 1986, the Ghana Chamber of Mines estimates that the industry has brought in more than 2 billion in foreign investment. If exploration efforts, new mine establishment and old mine rehabilitation is included, that number reaches US\$ 4 billion (*The London Times* 20/4/00).

Some companies outside the mining sector have in fact done quite well. Unilever Ghana, despite the power crisis of 1998 and falling disposable incomes, saw its sales volumes increase. By mid-1998, the company had reached its profit target for the year. Other firms have struggled as the economy has shown slow or no growth in recent years. But in general, foreign firms continue to show interest in Ghana. Telekom Malaysia Bhd, Malaysian Shipyard and Business Focus Sdn Bhd have investments in Ghana (*Business Times, Malaysia*, 28 July 1998). Chevron's West Africa Pipeline Project supplies Nigerian natural gas to Togo, Benin and Ghana. In general, reliable fuel and power supplies in Ghana have positively influenced foreign investment decisions (PR *Newswire*, West African Gas Pipeline, 9 December 1998).

The advantages of exporting from Ghana include low-cost labour, improving financial markets, free export zones, quota free access to US and European markets and membership in the Multilateral Investment Guarantee Agency (*Institutional Investor Survey*, August 1998). Also, Ghana has enjoyed relative political stability. President Rawlings will not be able to run for election in December 2000. He has supported his deputy Atta Mills as a candidate, who has generally avoided being in the public spotlight and is seen as a technocrat. In the past, Ghana has given up fiscal discipline during the lead-up to elections and it seems that this year may be no exception; however there are no fears of a military coup or instability at that level either.

It is the belief of ECOWAS members that its regional trade liberalization scheme, if agreed-upon trade protocols are implemented, would create a large market of approximately 250 million people to attract foreign investors. Attached to this effort, Ghana is trying to be perceived as the gateway to the region with the creation of export processing zones and attractive foreign investment policies. An EPZ has been established at Tema and other sites are planned at Takoradi, Kumasi and the Volta region. About 45 projects have been registered with more than half of those in operation.

The US\$ 56m Gateway project, mostly funded by a soft loan from the World Bank, is focused on the Tema Export Processing Zone launched in July 1999. World Bank funds will be used to improve infrastructure within the zone. However, the Bank will not release funds for infrastructure improvement until movement is seen on the private sector front. The response from the private sector has been positive so far. Among other firms, Business Focus, a Malaysian company will invest 300m over the next 6 years, making the Tema EPZ the first privately developed EPZ. The company plans to bring in 20 subsidiaries eventually. EPZ incentives in Ghana include a 10-year tax holiday and a maximum corporate tax rate of 8 per cent thereafter. Dividends are exempt from withholding taxes. Wholly-owned foreign enterprises are permitted. The minimum wage is set at US\$ 1 per day. In addition to the promotion of EPZs, the government



plans to improve the efficiency of agencies like the Customs, Excise and Prevention Services, the Ports and Harbour Authority, the Ghana Civil Aviation Authority, the Immigration Services, the Free Zones Board and the Ghana Investment Promotion Centre.

Ghana does have some advantages that will work toward the gateway concept becoming a reality. The country is politically stable, English is the language of business, infrastructure has improved over recent years and it is located on the coast in the middle of West Africa. Yet the crises brought on by drought and a loss of hydroelectric power have proved to be devastating to many industries. Land tenure issues are also proving to be a barrier to the commercialization of agriculture and the diversification of agricultural exports. Cocoa has not been privatized and most likely will not be, as it is one of the last bastions of state control. But other areas have potential like *robusta* coffee, of which only 6000 tons were sold in foreign markets in 1997.

Agro-industries including food processing could be a real driver of growth in Ghana. Pineapple, mango, paw-paw, passion-fruit, yams, cassava, bananas, cashews, black pepper and chilies have begun to be produced and exported but their sales have not yet taken off. There are several problems that need to be solved—the technological level is low, interest rates are excessive (35-45 per cent in real terms) and the supply of electricity is intermittent. Only the very large multinationals or very risk-averse investors have been interested in considering investments in the agricultural sector. It is very difficult to buy land of adequate size for large-scale commercial farming. Political and bureaucratic obstacles to obtaining land tenure abound. The right to farm the land must often be acquired from traditional chiefs with whom profits must be shared. From 1990-1995, agricultural growth averaged 2.8 per cent as opposed to President Rawlings' 1998 target of 4.4 per cent (*Survey-Ghana 98—Agriculture*, 21 June 1998). There is potential to expand production if the above-mentioned issues can be addressed.

Finally, investment in the natural gas sector in Ghana will help to improve the quality of the environment. The 620-mile offshore pipeline of the West African Gas Pipeline project will end the Nigerian oil industry's flaring of natural gas for lack of a market outlet. The flaring currently emits carbon dioxide and methane, two greenhouse gases. According to the Kyoto Protocol, developed countries can get credit for involvement in sustainable development projects that reduce emissions, in an arrangement known as the Clean Development Mechanism. All of the rules of this arrangement have not been finalized and the US and other countries have not yet ratified the protocol (*PR Newswire*, West African Gas Pipeline, 9 December 1998). However, if the agreement is finalized, it will create the right incentives for FDI in the natural gas sector in West Africa.

## **5 Conclusions**

We can draw several conclusions from the African experience. The first is that many of the problems with regard to attracting FDI in small economies are not that different than those in larger economies in the developing world. In particular, lack of infrastructure, cumbersome government regulations and restrictions on equity holdings by foreigners are common to both large and small countries. These obstacles to FDI must be addressed early on in the development process in order for economic development to

proceed at a good pace. FDI flows could be a lot higher in sub-Saharan Africa if governments implemented a proper set of regulations that enabled investors to do business in a fair and consistent manner. If the government enforces regulations in an arbitrary manner or writes tax and business codes that are contradictory and unclear, investors will stay away and/or seek other countries where the investment climate is more favourable. Similarly, if roads, electricity supplies and telecommunications are not adequate, investment flows will remain low.

The second lesson is that in very small countries, a single large project can be very significant in terms of raising interest in FDI. Mozal in Mozambique has given the country greater visibility in the international arena. A single large project, backed by a multilateral agency, serves to raise a large amount of capital, attract the attention of the media and bring together a number of different players from around the world. Large projects in small countries are also able to create secondary and tertiary businesses and employment opportunities fairly quickly, thereby increasing the economic development of the region. Also, if a small country is able to successfully implement a large project, it establishes itself as a credible host for FDI, thereby attracting further investment and employment. Thus, Mozambique has a lot riding on the success of Mozal. The project has done relatively well so far, increasing Mozambique's credibility to foreign investors looking for good investment opportunities in sub-Saharan Africa.

Third, *attempts at regionalization are important, particularly for small countries*. The Maputo Corridor links small economies to larger ones, thereby creating economic opportunities and increasing the size of the market. Cross-border projects are always useful in terms of increasing commerce and investment. But they appear to be almost a requirement for very small countries with limited domestic markets. It is clear that the returns to investment in cross-border projects that integrate the economies of large and small countries are high for both types of countries. Multilateral agencies such as the World Bank should pay particular attention to these types of projects.

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