

THE ATTRACTION OF THE FOREIGN DIRECT INVESTMENT (FDI) BY THE AFRICAN COUNTRIES.

By Mosima Makola*

1. INTRODUCTION

Foreign Direct Investment (FDI) is defined as international interest in which a resident in one country obtains a lasting interest in an enterprise resident in another. It is a situation where a foreign country creates a subsidiary to provide goods and services. Thus a firm undertakes FDI in a foreign market if it possessed an ownership advantage over the local competitors. The ownership of the foreign investment usually remains in the investing (home) country. FDI represents the primary means of transfer of private capital (i.e. physical or financial), technology, personnel and access to brand names and marketing advantage.

In most countries, FDI serves as one of the engines of successful transition. To a certain degree, counter-intuitively, most FDI are market-seeking and efficiency seeking motives.

United Nations Conference on Trade and Development (UNCTAD.1999) findings, reveal that FDI continues to increase at a global level as Multinational Corporations (MNCs) integrate their business operations throughout the world. The report confirms that the FDI transfer technology as well as firm specific assets to host countries. The foreign investors, e.g. USA, Japan and EU (i.e. Triad), and other countries penetrate global markets through FDI. Despite the dominance of market-seeking motives, foreign entities or foreign affiliates turn out to be more export-oriented than local firms. These investors have better access to internal production and distribution networks.

Primary problem to African regions deters foreign investors just as they do others. Limited market size and growth potential (i.e. in terms of per capita income), skill

shortage and poor infrastructure are some of basic primary problems affecting foreign direct investment.

FDI is an investment that crosses national borders. Dahl (2002) regards FDI as an investment that have the following three characteristics:

Equity capital – the foreign direct investor’s purchase of shares an enterprise in a country other than its own.

Reinvested earnings – the investor’s share of earnings not distributed as dividends by affiliates.

Intra-company loans or intra-company debt transactions – this is the short- or long-term borrowing and lending of funds between direct investors and affiliate enterprises.

The objective of this paper is to investigate the FDI trends in Africa. This will be followed by the factors and challenges involved. Subsequently we will discuss the findings and recommendation toward the goal of achieving FDI attraction by the African countries.

2. FOREIGN DIRECT INVESTMENT (FDI) ENVIRONMENT

The host country’s concern about FDI

Foreign firms are often more efficient than smaller local firms and have the resources to attract workers and finance away from host firms. Therefore the local industries are worried that the foreign countries will acquire monopsony control over the local resources. They are also concerned about the consistency of the transitional corporations (TNCs) on development goals.

The host country argue that FDI is better than borrowing abroad, because when business is bad, profits will not be available for repatriation. But the worry to host country is that prices of natural resources may be understated or overstated. Foreign investment may bring capital-intensive technology into labour-intensive environment and thus creates relatively few jobs.

National governments may disregard environmental concerns (for example oil spills problems in Nigeria) to attract foreign investments. The foreign investors’ contribution

to the local economy would be to increase saving, but some have contended that FDI actually decrease saving. The additional capital supply would reduce profits and interest rates, thereby reducing the incentive to save. Foreign investors may also have impact on local politics.

On the other hand, the investors or TNCs are concerned about the business climate. They prefer climate where taxes are low and the regulations are minimal.

The FDI is considered to be an important driver of economic growth by the countries of Organisation for Economic Corporation and Development (OECD). FDI can be measured in two different ways: financial investment flows and stocks. The coverage of the two measures differs, because FDI flows and stocks conventionally relate to ownership of 10 percent or more of the shares or voting power in an enterprise.

Foreign direct investment increased sharply in the late 1990s. They fell back somewhat in 2001. The globalisation of production increased significantly doubling the real inward FDI position of the average OECD country from \$81 billion to \$158 billion over the period 1990-2000. This increase also shows in the African countries (1983-1997). South Africa has an annual average of 84% increase in FDI inflows.

Foreign Direct Investment in Africa

Globally the mention of Africa evolves images of civil unrest, war, poverty, decess, mounting social problems. For this reason African countries are faced with a great challenge to attract FDI.

Most of FDIs are found in developed countries, and the emphasis is on manufacturing and finances. The question is, what will happen to less developed countries where the emphasis was primarily in agriculture, extractive industries and public utilities.

Number of African countries has been making serious efforts to liberalise external trade to attract FDI. In 1999, there was an estimated stock of \$865 billion worth of foreign direct investment in the world. The developed countries attracted nearly three quarters of the total inflow of FDI. Africa has during the last three decades managed to attract

more FDI from 8 dollars to almost 15 dollars per \$1 000 of Gross Domestic Product (GDP) between 19770-1997 (Dahl.2002).

Researchers believe that incentives for FDI must be identified in order to attract capital for economic growth and development of the industrial and manufacturing sectors.

Table 1. Inflows of FDI to Africa and groupings of countries in 1999

	US \$ billion	%
Developed countries	636	76
Developing countries	205	24
Africa	10	1.2

SOURCE: UNCTAD database

Table 1 illustrates how much more FDI flow into developed and developing countries than most poor African countries in 1999. Africa has received 10 billions of US\$ compared to 205 billion of US\$ by developing countries.

FDI in Southern African Development Community member states

The global structural change led the SADC countries to change to the direction of liberalisation, privatisation and deregulation of nation. A change in the state economies and the general commitment to trade.

There are number of countries regarded as ‘frontrunner’ by the foreign investors. These countries have attracted above-average amounts of FDI, not only in primary sector but also in secondary and tertiary sectors.

To be classified as ‘frontrunner’, a country had to perform well on at least one of the following criteria:

- Annual inflows of FDI
- FDI inflows per \$1 000 GDP
- Ratio of FDI inflows to gross fixed capital formation or
- FDI inflows per capita

Most of these frontrunners had number of things in common:

- A stable and predictable political policy and macroeconomic environment.
- Privatisation programmes have become a source for attracting FDI.
- Significantly higher GDP growth rates
- Efforts to improve the education levels of their citizens, well-developed infrastructure and favourable trade policies
- Deregulation paired with intense investment promotion activities.

Recent frontrunner countries, 1987 – 1996

- Botswana
- Equitorial Guinea
- Ghana
- Mozambique
- Namibia
- Tunisia
- Uganda

FDI stock, between 1990 and 1999 had significant upwards shift, stagnation or even decline in most SADC countries. Mozambique, which is one of the frontrunners, had an increase of stock of at least 100 per cent. This includes countries such as Zimbabwe, Lesotho and Angola. Namibia, Democratic Republic of the Congo and Botswana (one of frontrunners) had stagnation of FDI stock of 26%, 6% and 4% respectively (Dahl.2002)

Lesotho, unlike other mentioned seven countries, had huge inflow of capital to the multi-billion ‘Highlands Water Project’ underway. Others have managed to increase their stocks by 10%.

In 1998, Malawi (279%), Seychelles (78%), Angola (69%) and Zambia (52%), were the top 4 nations which demonstrated an inward stock of 20% or more of their GDP. In

1999 Mozambique had an inflow of 9.9%, just one digit below 10% of GDP received by Angola, Lesotho and Seychelles.

South Africa is outstanding in FDI inward stock with more than 17 US\$ billion. Angola is the second with 64 US\$ billion. All other SADC member states are spread out between 0,2 US\$ billion to 1,9 US\$ billion.

Seychelles turns out to be the country that attract most FDI/capita with an inward stock of 6,250 US\$ /capita in 1999. All SADC countries except for Mauritius and Seychelles are regarded as countries with low-skilled labour available at a low cost. Zimbabwe, South Africa and Namibia have very high unemployment rates. These countries push the salaries to a minimum in a situation of international competition.

GDP is an economic indicator which evaluates the size of the domestic market. South Africa has GDP of more than 130 US\$ billion and exceeds that of the rest of the 13 SADC member states combined.

Countries in Africa rank low in terms of competitiveness, compared to the rest of the world. To rank as a competitive nation, the country would need to appear on the top 30. Mauritius is the only country in Africa in the top 30. South Africa and Zimbabwe (in 1999) entered the list of the top 60.

Investors feel threatened by the high rate of external debts in African countries. They are of opinion that government would be tempted to tax the business community in order to meet external debt payments.

Table 2. Fulfilment of the 8 economic indicators among the SADC member states (FDI attracting countries in capital letters)

Number Scores	Countries
5	Botswana, LESOTHO, Namibia, Swaziland
4	MALAWI, Mauritius, Zimbabwe
3	Tanzania, South Africa

2	ANGOLA, MOZAMBIQUE, SEYCHELLES
1	Congo D.R, Zambia

SOURCE: UNCTAD

Foreign Direct Investment in SADC financial services

FDI is perhaps not as substantial in value term in the financial services sector, but it is important as it underlines a growing confidence in regional markets, and will help open up venues for future capital flows.

As new needs for public project financing emerged, foreign banks led by key South Africa players rapidly increased their involvement in regional activity. Though comparatively advanced, infrastructure can still be a problem, not only for the running of the banking sector, but also for the wider growth of competitive industry and agriculture.

Table 4 illustrates the dominance of the FDI financial Services by South Africa, and to a lesser extend, Portuguese companies. The costs of moving into or expanding in SADC must therefore increasingly be weighed up against the cost of not being there at all.

In recent years, 1997 and 1998, South Africa has targeted companies (Metropolitan Life of Botswana Ltd, New Merchant Bank, Botswana Insurance Holdings and Stockbrokerage) in Botswana. Three of the companies are new with the acquisition of one. For example Metropolitan Life of Botswana Ltd established a Joint Venture with Metropolitan Life in South Africa.

The FDI into the financial sector is explained by the following factors:

- The introduction of market-based economic reforms at national level to permit increased intra-regional and international participation in local financial capacity.
- Emerging policy reforms at regional level in order to harmonise, co-ordinate and integrate financial activity.

- The return of economic growth and macroeconomic stability in several countries to improved financial indicators, coupled with facilities financial sector reforms has helped to build to investor confidence.
- The appearance of new market opportunities that have provided ad hoc opportunities for foreign investment.
- The increasing movement of other private sector interests into the region in order to encourage home country investor activity.

Table 3. FDI into SADC Financial Services – 1990s

Investment Target	Country	Source Country	Source Company	US\$ m	Year	Kind
Housing Finance Corporation	Malawi	International	International Finance Corporation	30.0	1998	New
People's Development Bank	Mozambique	Malaysia	Southern Bank Berhard (SBB)	21.0	1997	Privatisation
Mozambique Investment Company	Mozambique	Portugal, UK	Banco Mello, CDC	19.0	1998	New
Standard Chartered Bank Zimbabwe	Zimbabwe	UK	Standard Chartered bank	10.9	1998	Expansion
Barclays Bank of Swaziland	Swaziland	South Africa	Standard Bank Group	10.2	1998	M & A*
Stanbic bank Zimbabwe	Zimbabwe	South Africa	SBIC Africa Holdings Ltd	10.0	1997	M & A
Commercial Bank of Zimbabwe	Zimbabwe	South Africa	Absa Bank, IFC	7.9	1998	Privatisation
Barclays Bank of Lesotho	Lesotho	South Africa	Standard Ban Group	6.9	1995	M & A
Banco Standard Totta de Moz.	Mozambique	South Africa	Standard bank Group	6.0	1995	M & A
Meridien BIAO Bank	Tanzania	South Africa	SBIC Africa Holdings Ltd	6.0	1995	M & A
Stanbic Bank of Zambia	Zambia	South Africa	SBIC Africa Holdings Ltd	5.0	1998	M & A
AJM-Banco de Investimentos	Mozambique	Portugal	Grupo Caixa Geral de Portugal	4.5	1994	New
Metropolitan Life Limited	Botswana	South Africa	Metropolitan Life	4.4	1997	New
New Merchant Bank	Mozambique	Portugal	Banco Portugues do Atlantico	4.0	1992	New
Banco de Fomento e	Mozambique	Portugal	Banco de Fomento e	4.0	1992	New

Exterior			Exterior			
----------	--	--	----------	--	--	--

SOURCE: BusinessMap SADC FDI Database. *M & A = Mergers and Acquisitions

3. NATIONAL POLICY FRAMEWORK

The general policy framework of FDI in Africa has improved greatly in recent years and is continuing in many countries. However, the FDI environment in Africa is still inadequate to attract high quality, efficiency-seeking, FDI. There are number of deficiencies that restrict incentives framework:

- Barriers to entry still exist in many countries because certain sectors are still reserved for domestic firms only.
- Generous and costly incentives for investment, in particular costly tax holidays
- The effectiveness of FDI promotion in Sub-Saharan Africa is generally low. (There are often insufficient private sector participation and they are also under-funded).

Pigato (2001) stated the following improvements throughout much of Africa:

- Most countries' in the region have concluded treaties and have signed multilateral agreements with international organisations (See table 4).
- Eastern and Southern African countries adhered to Cross Border Initiative (CBI) and adopted a common Road Map for Investment Facilitation. They agreed to establish one-stop centres that will process all applications within 45-60 days and grant automatic approval. The same investment Protocol is being finalised by all Unions in Africa (i.e. Central, West and Southern regions)
- Many countries are bringing tax rates in line with international norms. Tax systems still need to be rationalised and harmonised.

SADC countries are faced with the problem of budget deficit, which makes it difficult for them to fulfil criteria for receiving FDIs. Highest marginal tax (i.e. above 30%) restricts FDI attraction to these countries. However most of the African countries have improved their regulator frameworks. They permitted profit repatriation and provided tax and other incentives to attract investment.

26 of the 32 least developed countries in Africa covered in a 1997 survey had a liberal regime for the repatriation of dividends and capital (UNCTAD, 1999).

Political instability and unrest in the region, rank most countries lower than expected index of 70. Some countries, such as South Africa, Botswana and Namibia, qualifies but suffer because of 'bad neighbourhood' as referred to. SADC and Africa continent are ranked low by investors as compared to Asia and Latin America.

Most African countries had double-digit inflation rate in the 1990s, which is not favourable to investors. Privatisation programmes do usually attract FDI investments. SADC countries qualify except Angola, Congo D.R, Swaziland and Zimbabwe. Special law or act that regulated foreign investment is required. In 1998 South Africa and Swaziland were the only two countries without these laws. SADC countries qualify well in the criteria of multilateral investments.

Most African countries (50) had concluded bilateral investment treaties (BITS) with other countries, which clarify the terms under which FDI can take place between partner countries. Treaties tend to contribute more to the creation of a secure environment for foreign investors in the continent. Unfortunately, most SADC countries did not sign 10 bilateral investment treaties as required. Only few countries in the Southern Africa have maximum signing treaties as required. Same countries have signed double taxation treaties (DTTs).

African DTTs are however concentrated in a few countries such as Egypt, Mauritius, South Africa and Tunisia. These countries, unlike other African countries, already receive considerable amount of FDI. See the number of double taxation treaties concluded by African countries with developed and developing countries in 1999 as illustrated in table 3.

Table 4. The number of double taxation treaties (DTTs) by African countries – 1999

COUNTRIES	TOTAL WORLD
South Africa	47
Mauritius	29
Egypt	27
Tunisia	26
Zambia	19
Morocco	18
Zimbabwe	13
Nigeria	11
Kenya	11
Algeria	10

SOURCE: UNCTAD, FDI/TNC database

Development assistance may be a threat to countries which receive it. But this is not the case with the most SADC member states as they have received development assistance well below 10%.

The majority of African countries signed multilateral agreements dealing with the protection of FDI and established investment promotion agencies. For this reason, the policy framework of many African countries, has become similar to that of most other developing countries. Because of the negative image of Africa as a whole, it may not be sufficient to improve the investment climate to attract investors.

African countries joined differently agencies and become members in international agreements and institutions concerning FDI. Most of these countries joined these bodies a way back in 1960s.

- Convention establishing the Multilateral Investment Guarantee Agency
- Convention on the Settlement of Investment Disputes between States and Nationals of other states
- Convention on the Recognition and Enforcement of Foreign Arbitral Awards
- World Intellectual Property Organisation (WIPO)

4. THE FACTORS TO ATTRACT FDI

Many investors regards political and economic stability, availability of natural resources and a large and growing market as important factors to attract FDI. In a global environment, the following determinants are preferred:

- *A favourable environment* with low and stable rates and effective competition policies
- *Low transactions and business costs* for labour and trade regulations, entry and exit rules, location and environment regulation
- *Subcontract services to local firms*
- *Support quality assurance and technical extension* to SMEs
- *Human capital* with diverse modern skills
- *Low cost infrastructure* such as efficient communications system and transportation links.
- *Merger and acquisition*
- *Open policies in export activities* – i.e. free trade and free foreign exchange regimes to maximise economies of scale.

5. THE CHALLENGES IN AFRICA

The following shortcomings are still found in African countries:

- Many countries are still making it difficult to obtain expatriate permits (work permits) quickly and efficiently.
- The nature of the granting of investment incentives is variable. For example, South Africa grants several industry specific incentives (e.g. textiles and automobiles) and activities (innovation, SMEs). Ghana has abolished tax holidays in favour of low general tax rates.

- There are considerable variation in FDI entry procedures and requirements across African countries. For example, in Uganda, potential investors have to establish that the project generated economic benefits like foreign exchange, employment, use of local raw material, or technology transfer. Zambia requires a variety of different approvals by different agencies.
- Export Processing Zones (EPZs) are created as incentives but their effectiveness eroded by restrictive provisions and bureaucratic procedures.
- Africa experiences red tape as a main obstacle for investment. Administrative barriers should be liberalised. Most countries became operational.
- Poor reputation of Africa among foreign investors as a continent of starvation, war and high risk. Investors should have a different perception and see Africa as a good place for FDIs.
- The type of FDI should be identified. Africa needs resource-driven, market-driven and efficiency-driven FDIs.
- FDI statistics should cover the Africa continent as a whole.

6. THE FINDINGS

Countries with less population tend to have high FDI inward stock/capita, e.g. Seychelles. South Africa which ranked second in terms of FDI stock became ninth place.

Developing countries with good infrastructure, natural resources (e.g. oil reserves) tend to attract FDIs.

Most Southern African Development Community (SADC) countries fail to attract FDIs because they do not fulfil most of economic indicator criteria. They can not manage to keep their economic growth per capita higher than population growth.

Six of 14 states in the SADC countries show 80% of the literacy rate. Zimbabwe became closest to reach over 90% criteria with a literacy rate of 87,5 per cent.

The countries in SADC are regarded as having generally high access to foreign markets because they have exports that make up between 30% and 50% of the GDP.

The mix of countries in the four organisations (i.e. SADC, COMESA, EAC, and SACU) is an obstacle to an effective reduction of barriers to investment in Southern Africa. Investors in Africa identify the domestic markets as important for investment, and not only for export (Dahl, 2002).

Most of African countries are low-cost and unskilled labour countries that may be expected to attract investors. These countries have not succeeded in doing so because of restrictive provisions, bureaucratic procedures and weak government bodies established to develop and operate the zones.

Countries with high political and country risk may attract FDI only if the country can counter balance this with low risk exposure in other countries.

Ghana and Uganda have been successful examples of privatisation with strong participation of foreign investors. To achieve this, the host countries should set clear rules regarding the privatisation procedures. They should also set transparent and solid regulatory framework for the sectors that are being privatised.

7. FDI ATTRACTION IN AFRICA

African countries are faced with great challenges of the promoting peace, economic prosperity and political stability. The African leaders, stakeholders and policy makers, etc. should do this by themselves. It should play its full part in the global economy (UNCTAD, 1999). African countries should display opportunities and assure foreign investors good and high return in their investment from the continent.

African countries should change their image. They should show the world that they are no longer torn apart by the civil unrest and wars but growing and stabilising. It is also time for foreign investors to treat Africa differently.

The question is how can macro-economic and political stability be achieved in order to attract FDI into the region? Substantial increase in FDI is required and can be achieved by paying attention to the following issues:

(a) Macro-economic stability

- **Macro-economy environment**

Investors need reduction in inflation and positive real interest rate to restore confidence in investment.

- **Public sector enterprise**

Privatisation of the state owned enterprises should be pursued to allow the enterprise to operate in an efficiency-oriented environment to achieve profitability. Clear rules regarding the privatisation procedures should be set. Export processing zones should also be established.

Joint ventures and partnerships should be part and parcel of the changes.

- **Tax and incentive regime**

African countries should upgrade their national laws and incentives for best international practices. This could be achieved by lowering transaction costs, improving the supply of skills, rationalise tax rates and incentives.

- **Human development / human capital investment**

Qualification framework should include school, work based / basic skills, vocational and professional.

- **Investment promotion agency**

Agency should be placed directly under the authority of the office of the head of state.

- **Infrastructure**

There should be establishment of regulatory agencies and a framework for negotiating contracts, which optimise benefits for the host country.

Agencies are needed to assess new opportunities that private participation and innovative financing have to offer in infrastructural sectors (energy, water, transport and communications). The promotion of regional transport corridors and the parallel national Spatial Development Initiatives.

(b) Political stability

Political stability is imperative. The transmission of cultural values among countries through the vehicle of foreign direct investment should be avoided. African countries should adopt sense of tolerance among themselves to stabilise the environment.

8. CONCLUSION

Most investors prefer to choose their investment location and not the government by decree. This was the case in Estonia. Estonia turned into an export-processing zone which was a relatively hassle-free administrative environment for business and relatively good infrastructure. Hungarian industries also attracted investors by becoming free trade zone.

In the SADC region, South Africa and Mauritius are regarded to be flying geese whereby other remaining countries are regarded to be the leaping frogs. All the African countries, the flying geese and the leaping frogs should get courage of following the two countries. This would lead to attraction of more FDIs in the continent.

To foreign investors “Treat Africa like any other continent or region. Do not simply write it off, but have a differentiated look. Look at it closely, country by country, industry by industry, and opportunity by opportunity. Your competitor may well be there already” (Odenthal L, et al. 1999).

9. REFERENCES

1. Broll U (2003) Foreign Direct Investment, Credible Policy: The role of Risk Sharing. *International trade journal*, Volume XVII, N0.2. p165-176.
2. Dahl J (2002) Incentives for Foreign Direct Investment – The case of SADC in the 1990s. NEPRU Working Paper. No. 81. Namibia.
3. Heese K (2000) Foreign Direct Investment in South Africa – Confronting globalisation. *Development Southern Africa*. Vol. 17 Issue 3.
4. Kalotay K (2003) Foreign Direct Investment in the Estonian Economy. *Journal of International Relations and Development*. Vol. 6 Issue 2. P207-210
5. OECD (2003) Foreign Direct Investment Restrictions in OECD Countries. *Economic Outlook*. Issue 1.
6. OECD (2003) Policy influences on foreign direct investment. *Economic Outlook*. Issue 1.
7. OECD (2003) Trends in Foreign Direct Investment in OECD Countries. *Economic Outlook*. Issue 1.
8. Pigato M. (2001) The Foreign Direct Investment Environment in Africa – Africa Region, The World Bank.
9. Ram R and Honglin ZK (2002) Foreign Direct Investment and Economic Growth: Evidence from Cross-Country data for the 1990s. *Economic Development and Cultural Change*.

10. Rob R and Vettas N (2003) Foreign Direct Investment and Exports with Growing Demand. Review of Economic Studies. Vol. 70. Issue 3. P629-648.
11. UNCTAD (1999) United Nations Conference on Trade and Development. New York and Geneva. United Nations.
12. UNCTAD (1996) World Investment Report. Investment, Trade and International Policy Arrangements. An Overview. Geneva.
13. UNCTAD (1998) World Investment Report. Trends and Determinants. An Overview. Geneva.
14. FDI in SADC Financial Services: Follow the leaders.