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INCREASING FOREIGN DIRECT INVESTMENT IN AFRICA

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The Importance of FDI in Africa

Foreign investment is important for Africa and the international community as a whole. It is important for Africa because, among other things, the continent does not have adequate savings and foreign exchange resources of its own needed for the desperately urgent task of promoting the development of its economies and diversifying their structures with a view to promoting stability. African countries are also severely short of certain skills and technologies needed for development and diversification of their economies. There are problems which could be alleviated by more direct investment by TNCs in Africa. TNCs would appear to be the most effective mechanism for dealing with such problems because, by and large, those firms have the requisite resources and qualities - the necessary internal organizational strength, management skills, access to capital and technology, and flexibility or room for manoeuvre (in the sense that they can operate in an objective, business-like manner, unlike programmes sponsored and implemented by Governments). Although FDI in Africa is now limited, it plays a very useful role, especially in the promotion of the modernization process. At the same time, the potential role of FDI in Africa is tremendous.

Increased FDI in Africa is important for the international Community because, by promoting development in the continent, it would increase Africa's effective contribution, economically and otherwise, to the international community; it would ensure utilization of natural and human resources now lying idle; and, by leading to increased development, especially in the areas of employment and good production, it would create political and social stability. There are two rather brave assumptions behind these arguments. First, it is assumed that the rest of the world (especially the industrial countries) takes a long-term view of international economic co-operation which is not wholly motivated by selfish and short-run commercial advantages. Second, it is assumed that the rest of the world (again basically the industrial countries) accepts equitable management of the increasing international economic interdependence as the only way of ensuring stabilty and prosperity in this world -a world in which no country can live in total isolation.

Those two assumptions are about policies of other countries and their Governments. As far as TNCs are concerned, it is recognized and accepted that they would not invest in Africa unless they were sure of adequate rates of return to this investment, securing firm access to the raw materials they need, and developing further markets for their products. But, in spite of this reality, the aims of TNCs and the development requirements of the African countries are not in conflict provided that all short-run and long-run aspects of the co-operation between African countries and TNCs, including respect for the political independence of the African countries are not in conflict provided that all short-run and long-run aspects of the co-operation between African countries and TNCs, including respect for the political independence of the African countries, are given sufficient recognition. Such considerations should include avoidance of short-run exploitative arrangements of devices by TNCs in favour of investment for mutual benefits in the medium and long term. In any event, African countries recognize the importance of FDI inflows for active partnership in the promotion of their development efforts.

Recent trends in FDI in Africa

As already observed, FDI in Africa is very small and is declining. In global terms, the estimates are that about 60 per cent of FDI in the developing world is in Latin America, 30 per cent in Asia, and only 10 per cent in Africa. This distribution of FDI is not surprising, because Latin America and Asia are more developed and diversified economically than the African countries, those regions have had longer established and more experienced financial and other institutions which attract or co-operate with TNCs, and they also have more local entrepreneurs who have established contacts with foreign investors. The countries of Latin America and Asia have also been politically independent much longer, which, in turn, is responsible for many other factors affecting FDI. For example, they have had more time to design their policies, and they have more of their nationals working in industrialized countries with TNCs, universities, banks, international organizations etc. The latter point is often extremely important in influencing the flows of FDI and multilateral assistance.

But more worrisome than the small volume of FDI in Africa is that it has been declining in recent years. In other words, there has been a disinvestment by TNCs in Africa. Briefly, during the post-independence years, in the 1960s and 1970s, there was some active FDI. Starting with the oil crisis of 1979, however, the increase in the volume of FDI stopped. The investment climate in the continent deteriorated rapidly owing to shortages in foreign exchange, various other economic difficulties created by the unfavourable international environment - especially the deterioration in the terms of trade; the growing lack of access to foreign capital; declines in official development assistance; rapid increases in the external indebtedness of almost all African countries; social and political instability in a number of African countries as a result of either internal strife or border conflicts; and the economic and social hardships created by the severe drought in the early 1980s which afflicted most countries of the continent with terrible losses of livestock and food supplies.

The deterioration in the investment climate in Africa was also due to other factors, such as the emergence of the debt problem in developing countries generally, and Latin America in particular, and the uncertainty it created among banks and investors; a decline in the profits of TNCs in Africa engaged in the production of primary products for export, because of declines in export prices and increases in the costs of imported inputs; high interest rates abroad leading to the pressure to increase remittances of profits and dividends (and this is important because reinvestment of profits has been a major source of additional investment in Africa); and the increased attraction of TNCs to invest in industrialized countries. Most of those factors are still relevant and they should be borne in mind when thinking about the future.

The problem of foreign exchange shortages and external debt deserves serious attention. The shortages of foreign exchange meant that spare parts could not be imported which, in turn, meant that existing plants had to operate (and still do in the majority of cases) well below capacity. Furthermore, infrastructural facilities could not be properly maintained, nor could the imports of the necessary consumer goods. Foreign direct investment is not encouraged when such conditions prevail - a situation which, quite rightly, has been referred to as "import strangulation". In fact, as mentioned, disinvestment has been taking place.

The situation has been further aggravated by the increase in external debt, which grew from about $93 billion in 1980 to about $240 billion in 1987. More illustrative of the extremely serious debt problem facing many African countries is that debt-servicing ratios are now well over 50 per cent, and considerably more in some cases. When the servicing of external debt takes so much of a country's export earnings, FDI is discouraged because investors become uncertain that the country will be able to authorize the remittance of profits, given licences for the necessary imports, and generally maintain a peaceful and stable social and political environment. From almost every point of view, a solution to Africa's debt problem must be regarded as an integral part, perhaps even the starting point, of any organized programme for increased FDI in Africa.

In recent years, FDI has also declined in other developing regions of the world because of, among other things, debt problems and the investment attractiveness of various industrialized countries (for example, high interest rates on government paper, new investment areas, especially in the services sector, concentration by TNCs on mergers or acquisitions etc.). Over the past several years, developing countries, including African countries, have had to devote much of their time to the debt situation and related discussions with creditors and the International Monetary Fund and the World Bank. As a result, very little time has been available to work on policies and programmes for increasing investment, including FDI. The cost of debt is therefore much greater than the debt service. And, of course, there is the additional point that the existence of the debt and inconclusive discussions on how to deal with it has been a major factor in reducing the creditworthiness and investment attraction of those countries. In terms of development, the existing debt is truly a major cost and obstacle. A solution must be found so that attention can be given to development matters which, incidentally, would certainly benefit both the debtors and creditors. Above all, it would be tragic to let the problem drag on, with the creditors hoping that some good fortune will come along to enable the debtors to repay in full. Courageous international action is needed to remove this obstacle to the welfare of the world as a whole. It is an unacceptable situation when the poor countries, with severe human and economic development problems, have to transfer 5 per cent and, in some cases, even more of their GNP to rich countries every year to service their external debt.

With regard to recent investments by TNCs in the industrialized countries in the form of government paper and mergers or acquisitions, it should be pointed out that that is not the kind of investment which creates jobs. This partly explains the high levels of unemployment still prevailing in some of those countries in spite of low inflation and some increases in the GDP. In fact, from the point of view of welfare and the rational allocation of labour and other resources internationally, some of the investments in the North in recent years are simply not appropriate.

Foreign direct investment has an important role to play in overcoming these economic problems facing the countries of the world - indeed, it must be an integral part of the solution in order to make use of the many existing opportunities to improve human welfare. And if FDI is undertaken in an efficient and equitable manner, it can also make a major contribution towards international peace and security. Deliberate measures at the international level are therefore absolutely necessary for the promotion of FDI.

Measures to promote FDI in Africa

The first point to recognize under this subheading is that promoting increased FDI in Africa should be seen in comprehensive terms, and certainly as a task in which gimmicks and unrealistic theoretical exercises should be avoided. Above all, those factors behind the poor performance recorded in the area of FDI in Africa in the past, and some of which were mentioned above, should be addressed realistically and courageously. Determined action is needed at three levels: the level of the individual country; the level of the region as a whole, or at least at the subregional level; and the level of the international community.

Action at the national level

The basic task at the national level is that of creating a favourable investment climate and re-establishing creditworthiness. Some of the measures needed, in which the main responsibility lies with a country itself and its Government, are the following:

- *Ensuring peace and political stability. That is a prerequisite for FDI.*

- *Government encouragement of private investment.* Fortunately, there are, with the possible exception of one or two countries, no ideological barriers to private-sector participation in the development process. The problem which remains is that most African countries have yet to design realistic programmes for actively encouraging such investment. One such programme, which should be given priority, is the development of African entrepreneurs. Foreign direct investment cannot flourish in a sustained fashion unless domestic private investment is also active and growing. One of the effective ways of attracting FDI is to promote joint ventures between TNCs and local enterprises. The importance of developing local entrepreneurs cannot be emphasized enough.

- *Introduction of appropriate incentives for investors.* For example, more effective tax incentives, arrangements for production in bond, preparation of industrial sites, and the retention of portions of foreign exchange earnings for required imports.

- *Removal of restrictions which inhibit private investment.* For example, inappropriate price controls and import licensing systems, restrictions on local borrowing by foreign-owned enterprises, and the inappropriate use of work permits, which makes it difficult for foreign investors to employ non-nationals to manage their investments while local managers may not be available or adequate. In addition, more FDI will need skills of various types, such as experienced mechanics and foremen, accountants, technologists and engineers and, in some cases, competent secretaries. Where those skills are not available, they should be imported and, at the same time, programmes should be initiated from the more developed developing countries because the nationals of such countries are likely to cost less and may also help more effectively in modifying imported technologies to make them more appropriate, given the resources and circumstances of the host country.

- *Elimination of corruption.* This is a factor which seriously inhibits FDI, in addition to creating other major economic, social and political problems. When foreign investors are expected to bribe an official for approval of an investment proposal, for the required licences and work permits etc., they are unlikely to feel enthusiastic about going ahead with their investment. Where investment is undertaken through corrupt practices, which increase investment costs, foreign investors can manipulate the situation and protect their positions by over-pricing the equipment, charging higher prices for products and similar devices, with the result that the net loser in the end is the country itself. Extreme cases of corruption in this field involve collusion between local bureaucrats and investors, who make all the money they expect to make from the investment through overcharging for the equipment and inflated construction and installation costs. The result is that the completed project becomes a white elephant, which, in the end, is often abandoned.

Unfortunately, there are a number of examples of this in Africa. Corruption is both immoral and antidevelopment, and African countries must not tolerate it if they wish to improve their investment climate.

- *Administrative efficiency*. The importance of this element is often underestimated in development economics, and in the area of FDI, it is particularly important. The host country needs to have people who are able to discuss matters comprehensively and in a business-like manner with foreign investors. Furthermore, there should be consistency and transparency in policy formulation. Predictability is an important factor in investment, especially for FDI, and it will not be achieved unless government policies are transparent, consistent and harmonized.

- *Preparation of lists of investment projects*. An important factor in promoting FDI in Africa and ensuring that such investment takes place in the needed sectors is that of preparing lists of possible projects for foreign investment. Where a country is unable to prepare such material, it should enlist the support of outside experts, who are often expensive and also may not always give objective advice. They therefore need to be supervised. This is an area in which such institutions as UNCTC, the African Development Bank, subregional development banks, and the World Bank should be ready to provide the assistance needed.

- *Infrastructural facilities*. These facilities in Africa are either non-existent or are totally inadequate; those few that are available are deteriorating rapidly because of lack of maintenance. Roads are disintegrating, railway systems operate well below capacity, there are frequent power failures and hopelessly inadequate water-supply systems in the urban areas. In addition, decent housing is in short supply; and telecommunication systems are often unreliable, costly and, in many cases, slow (for example, telexes often have to be sent through European capitals). And yet, infrastructural facilities should be expanding because of increases in population, the urgent need to promote development and to attract private investment from outside. Each and every African country must do whatever it can to improve this situation. It is also recognized, however, that because of foreign exchange problems, African countries will not be in a position to do much on their own. It is suggested, therefore, that the World Bank should take the initiative in the rehabilitation and development of infrastructural facilities in Africa. Such an exercise would be import-intensive (in terms of equipment and consultants) and, consequently, it should also receive attention of bilateral donors.

Action at the regional level

At the level of the continent as a whole, and also at the "subregional" level, 1/ co-operation for development, including attracting FDI, is of utmost importance for many reasons, including the following:

- *Domestic markets are often very small and therefore unattractive to FDI.* The result is that either small-scale and inefficient enterprises are established, or costly larger ones are created which then operate well below capacity and therefore become uneconomic. Such investments then become barriers to economic co-operation among neighbouring countries, as each country tries to protect its industry. African countries must therefore lose no time in establishing larger markets through co-operation.

- Countries should launch joint efforts to attract FDI rather than embark on competitive efforts to offer more incentives and advantages than their neighbours. Actually, African countries need to do more than merely harmonize their policies and efforts in this area because of the need to base their economic co-operation on production-sharing (see below).

- Infrastructural development programmes in Africa will not be efficient or effective unless neighbouring countries co-ordinate their plans, for example, so that roads meet each other, railway gauges are standardized, and power development schemes could eventually be connected through grid systems.

The high degree of co-operation needed can only be secured if every country involved recognizes that it will benefit therefrom. Above all, co-operation should be approached through the sharing of production, which, in the case of agricultural products, can hopefully be based on comparative advantages. What Africa needs is not the classical framework of a common market or customs union with market forces left to work on their own. What is needed is rather the kind of approach to be found in the Southern African Development Co-ordination Conference, where co-operation is based

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1/ In the 1960s, Africa was divided into four subregions by the Economic Commission for Africa for purposes of promoting economic integration: the Eastern African subregion (now covered by the countries of the Preferential Trade Area for Eastern and Southern African States); the Central African subregion; the Western African subregion (now covered by the Economic Community of West African States); and the Northern African subregion, which includes the Sudan.

on production-sharing with agreement on the necessary trade arrangements to support that production 2/.

Economic co-operation on the basis of the subregional framework is perhaps the most sensible and practical approach for the present. However, there are measures at the continental level which African countries could undertake with substantial benefits. The first is a more energetic use of the continental institutions, especially the African Development Bank, to attract investment from outside - directly and indirectly. The second is a more deliberate use of the Organization of African Unity (OAU) to promote political willingness among African countries to co-operate, and also to reduce those border tensions and conflicts which are now partly responsible for the unfavourable investment climate prevailing in some parts of Africa. Economic co-operation is *au fond* political co-operation, and without peace there will be little investment, let alone higher inflows of FDI. The OAU has vital role to play in those two areas.

Action at the international level

It can be said without fear of contradiction that whatever African countries do on their own will not be adequate to provide a condition sufficient to ensure a reversal in the flow of FDI, let alone increase substantially the volume of such flows. Action at the international level is one of the necessary conditions, and the measures needed at this level should include the following:

- An early solution to the serious debt problem now facing African countries, especially those of sub-Saharan Africa. The debt has not only arrested development, but is actually a major obstacle to any recovery.

- Foreign assistance from the World Bank, other multilateral organizations and bilateral sources, to rehabilitate and construct additional infrastructural facilities needed for development in general and for laying one of the necessary foundations for FDI.

- Greater involvement of multilateral organizations, especially the international Finance Corporation (IFC) and other investment organizations, including bilateral ones, in joint financing activities with TNCs. With respect to Africa, the IFC should take the initiative rather than wait for TNCs to initiate joint investment.

- More use of such mechanisms as import-export banks and bilateral credit and export guarantee organizations to support

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2/ For a further discussion on this subject, see the author's article entitled "Co-operation among sub-Saharan African countries: an engine of growth?", in the Journal of Development Planning, No. 15, 1985, pp. 137-161.

investment in Africa. In that connection, a significant recent development is the Multilateral Investment Guarantee Agency (MIGA), which, one hopes, will be used energetically and imaginatively to encourage the flow of investment into Africa and other developing regions.

- *Trade issues*. While it has been argued that initially African countries have to follow a strategy of expanded import substitution through economic co-operation among themselves, there is no doubt that exports abroad are necessary for development purposes in general, and also for supporting further TNC investment in the continent. Protectionism in the industrialized countries against agricultural products and manufactures from Africa and other developing regions is widespread and a significant barrier to further investment and development. The issues involved are well understood, and the negative effects of protectionism itself are widely recognized. Unfortunately, there continues to be a lack of action to remove trade-restriction practices by the industrialized nations, especially against goods coming from the developing countries. At the same time, it is absolutely clear that, whether one is considering payment of external debts or greater FDI investment in Africa and other developing regions, the removal of such trade restrictions is one of the necessary conditions.

- *Political support*. TNCs are often influenced by the foreign policies of their home countries. Faster development in Africa is of direct benefit to the industrialized countries as well, for example, in terms of expanded markets, in reducing unemployment in the North (through export of consumer goods, whose demand in the North is now more or less static), through exports of capital goods etc., in increasing efficiency in the production of raw materials needed in the North, and in terms of peace and stability. The current political leaders in the North do not appear to attach much significance to those arguments and to the importance of equitable internationalism. A change in the political outlook in the North in this area would have considerable impact on the investment strategies of TNCs in Africa.

Some specific measures to promote FDI in Africa

The starting point in the task of promoting FDI is to deal with the factors now responsible for the poor investmet climate in Africa. Moreover, in the preceding section a number of recommendations on the general measures which should be taken at various levels have been made. In the present section a few specific measures which should be considered are discussed. The list is not, of course, exhaustive.

- *Use of parastatals* (state enterprises). In the early years after independence, most African Governments established parastatals to produce and distribute goods and services. But, as their economies have become more mature, so has the need to adopt new management styles and techniques in most spheres of economic activity. One result of this reflection is the increasing acceptance that African Governments should disengage from those state enterprises that would be more efficiently and profitably run as private businesses. The process of divestiture should not be restricted to industrial enterprises. Those parastatals dealing with electricity, water and sewage, railways, airlines and telecommunications, also tend to be natural monopolies so that the issue of market size is not often a major constraint. Parastatals are, therefore, fertile areas in which to invite the participation of FDI. That approach has a number of advantages. First, it creates opportunities for joint ventures between FDI and local enterprises. Second, it provides an opportunity to inject new technology and management in major infrastructural facilities, which is needed in any case, and which is necessary for further FDI and general development.

- *Provision of information.* African countries do not always know which TNCs invest in what. On the other hand, many TNCs are not well informed about Africa - and the little they know is often seriously distorted and biased against African countries. Action is needed to improve information and knowledge. In this task, such bodies as UNCTC, the European Investment Bank, the International Finance Corporation and UNIDO could be of enormous service. Carefully organized investment seminars and workshops would be very beneficial.

- *Debt-equity conversion and swaps.* Recently, a number of techniques such as debt-equity conversion and swaps, currency and interest-rate swaps, have come into use to reduce the debt burden and to protect individual borrowers from adverse currency and interest rate movements. Those techniques are, however, of limited value to Africa, because much of the African debt is owed to foreign Governments and to multilateral institutions, especially IMF and the World Bank. Moreover, what Africa desperately needs is more foreign exchange, while the conversion of debt into equity does not bring this about - in fact, the profits and dividends earned would still need to be remitted. Another factor is that unless an enterprise is profitable, it is unlikely that foreign lenders would accept conversion of debt into equity. In spite of these arguments, debt-equity conversion should be encouraged, as foreign investors would then have to take a long-term view as far as the development of the host country is concerned. Their involvement might also attract other foreign investors in due course. An attractive field for such conversions might be parastatals which, as noted above, have protected markets and need, in any case, further injections of capital and, often, management.

- *Establishment of appropriate legal frameworks.* The legal framework of a country can encourage or discourage FDI. For example, certain provisions in labour laws (such as minimum wages and mechanisms for the settlement of labour disputes which are punitive to the employer) can be a positive discouragement to FDI. Legal frameworks in most African countries were inherited from former colonial Powers. In some ways, those laws were designed to discourage contact between the colonies and countries other than those associated with the colonial power. In many African countries, colonial legacies still exist in their laws. In order to encourage FDI generally, African countries should review their legislation and make it universally more applicable, for example, extending double-taxation agreements to other countries in addition to former colonizing nations.

- *Streamlining the licensing procedures.* In many African countries, foreign investors must obtain approval from several government departments before they can expand their existing plants or start new enterprises. This causes investment delays. In a world where prices of materials, interest rates and exchange rates fluctuate constantly, such delays may lead to an escalation in the cost of projects, in addition to discouraging foreign investors. One way of encouraging FDI is therefore to reduce bureaucratic delays in the approval of projects by setting-up "one-stop" offices.

- *Review of the development strategy.* In preparing lists of feasible investment projects, Governments of African countries need to take stock of their development strategies thus far, in order to encourage projects that quickly attract FDI while, at the same time, maintaining the economy on the appropriate development path. Much of FDI in Africa today is in extractive industries and agriculture. Given that situation, it would appear that the most beneficial approach would be to take measures that would encourage the expansion of existing FDI or would attract new FDI in areas such as the agribusiness, paper and wood products, metallurgical and chemical industries, that is, taking the existing resource-based industries a step further.

- *Use of counterpart funds.* The occurence of frequent droughts, problems in the procurement of vital inputs owing to shortages of foreign exchange, and glut of certain commodities in the industrial countries have led to the provision of foreign aid in the form of commodity aid. The counterpart funds that are generated after the sale of those commodities in the recipient country sometimes remain idle for long periods in the central banks or designated financial institutions. Counterpart funds like these could be used to support local private-sector activities generally (and thereby develop opportunities for joint ventures with FDI), or, where there are restrictions on local borrowing by foreign companies, the funds could be used to support expansion programmes of TNCs from the donor country.

- *Tax incentives.* The use of tax incentives is necessary, although they are not as important as improvements in infrastructural facilities. Such incentives, however, need to be designed properly so that they can be real incentives instead of unnecessary gifts. One measure which could be an important incentive is to allow foreign exchange losses in tax returns. Such losses have made borrowing abroad very costly, and many enterprises have become unviable simply because of the devaluation of local currencies and the appreciation of foreign ones in which the loans were incurred and denominated. In these days of fluctuating currencies and steady devaluation of African currencies, the offsetting of such losses appears necessary in order to assist in the structural adjustment of their economies.