Performance, Promotion, and Prospects for Foreign Investment in Africa: National, Regional, and International Responsibilities

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Abstract

This paper examines the performance, promotion, and prospects for foreign direct investment (FDI) in Africa. Factors such as political and macroeconomic instability, weak infrastructure, poor governance, inhospitable regulatory environments, and ill-conceived investment promotion strategies, are identified as responsible for the declining FDI trend in the region. The paper advocates a new approach to investment promotion in the region that focuses on the improvement of relations with existing investors and giving them an incentive to assist in marketing domestic investment opportunities to potential foreign investors. It also argues that the current wave of globalisation sweeping through the world has intensified the competition for FDI among developing countries. Consequently, concerted efforts are needed at the national, regional, and international levels in order to attract significant investment flows to Africa and reverse its historically dismal FDI record.

Keywords: Foreign Investment; Promotion; Africa; Responsibilities
JEL Classification: F21; F23; O55

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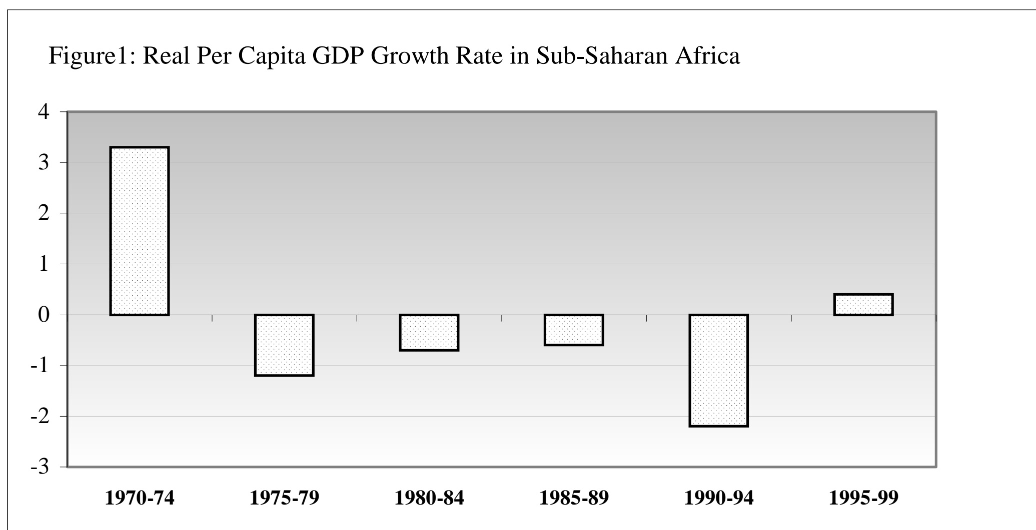
Introduction

After gaining political independence in the 1960s, African countries—like most developing nations—were very skeptical about the virtues of free trade and investment. Consequently, in the 1970s and 1980s several countries in the region imposed trade restrictions and capital controls as part of a policy of import-substitution industrialization aimed at protecting domestic industries and conserving scarce foreign exchange reserves. There is now substantial evidence that this inward-looking development strategy discouraged trade as well as foreign direct investment (FDI) and had deleterious effects on economic growth and living conditions in the region. For example, available data indicate that annual average growth rate of real GDP per capita in the Sub-Saharan Africa region fell from 3.3% in the period 1970-74 to –2.2% over the period 1990-94 (Figure 1). Furthermore, about a third of countries in Sub-Saharan Africa had lower per capita income in 1994 than they did in 1960 (see Rodrik, 1998).



Source: Figure based on data in Fosu (2001).

The disappointing economic performance of African countries beginning in the late 1970s up till the mid 1990s, coupled with the globalisation of activities in the world economy, has led to a regime shift in favour of outward-looking development strategies. Since 1995, there has been a relative improvement in economic performance in a number of African countries as a result of the change in policy framework (Fischer et al, 1998).

But the progress made so far is not enough for sustained growth and development in the region. Over the past five decades, Africa's participation in the world economy has declined. The region's share of world exports fell from 4.6% in 1980 to 1.8% in 2000. Its share of world imports declined from 3.6% to 1.6% over the same period (Table 1). Furthermore, Africa's share of global inward FDI flows fell from 1.8% in the period 1986-90 to 0.8% over the period 1999-2000 (Table 2). These figures are well below the developing countries average of 17.5% and 17.9% over the same period.

Table 1: Distribution of World Trade (1980-2000)

Share of World Exports (%)

Region/Economic group	1980	1990	2000
Developed market economy countries	63.85	71.51	64.03
Developing countries and territories	28.62	23.85	31.98
Countries in Eastern Europe	7.54	4.64	3.99
Africa	4.62	2.29	1.84
North Africa	2.17	1.06	0.84
Sub-Saharan Africa	2.45	1.23	1.00
Asia	17.94	16.91	24.23
America	5.50	4.16	5.57

Share of World Imports (%)

Region/Economic group	1980	1990	2000
Developed market economy countries	69.08	72.51	67.34
Developing countries and territories	23.68	22.59	29.06
Countries in Eastern Europe	7.23	4.9	3.6
Africa	3.63	2.35	1.56
North Africa	1.52	1.25	0.81
Sub-Saharan Africa	2.11	1.11	0.75
Asia	13.08	15.93	21.1
America	6.07	3.65	5.91

Source: UNCTAD (2002a).

Table 2: Distribution of World FDI Inflows, 1986-2001 (Percentage)

Region	1986-1990	1991-1992	1993-1998	1999-2000	2001
Developed countries	82.4	66.5	61.2	80.0	68.4
Developing countries	17.5	31.2	35.3	17.9	27.9
Africa	1.8	2.2	1.8	0.8	2.3
Central and Eastern Europe	0.1	2.2	3.5	2.0	3.7

Source: UNCTAD (2002b).

More improvements in economic policy and performance are needed to enable the region reach the minimum growth rate necessary to meet the Millenium Development Goals set by the United Nations. An increase in investment is crucial to the attainment of sustained growth and development in the region. This requires the mobilisation of both domestic and international financial resources. Given the decline in Official Development Assistance (ODA), the high volatility of short-term capital flows, and the low savings rate of African countries, in the short-run the desired increase in investment has to be achieved through an increase in FDI flows to the region.

Until recently, FDI was not fully embraced by African leaders as an essential feature of economic development, reflecting largely fears by some that it could lead to the loss of political sovereignty, push domestic firms into bankruptcy due to increased competition and, if entry is predominantly in the natural resource sector, accelerate the pace of environmental degradation. Although some of these concerns are legitimate—for example, there is some evidence that the activities of foreign firms in the Nigerian oil industry have had perverse effects on the local environment—experience has shown that if a host country creates a conducive environment for investment, FDI can play an important role in its development efforts. Its potential benefits to a host-country include:

- *Employment generation and growth*: By providing additional capital to a host country, FDI can create new employment opportunities resulting in higher growth. It can also increase employment indirectly through increased linkages with domestic firms. More specifically, the location of a foreign firm in a host country generally leads to the establishment of domestic firms that provide inputs to it thereby increasing the demand for labour in the economy.

- *Supplementing domestic savings*: African countries have low savings rates thereby making it difficult to finance investment projects needed for accelerated growth and development. FDI can fill this resource gap between domestic savings and investment requirements.

- *Integration into the global economy*: Openness to FDI enhances international trade thereby contributing to the integration of the host-country into the world economy.

- *Raising skills of local manpower*: through training of workers and learning by doing, FDI raises the skills of local manpower thereby increasing their productivity level.

- *Transfer of modern technologies*: Foreign firms typically make significant investments in research and development. Consequently they tend to have superior technology relative to firms in developing countries. FDI gives developing countries cheap access to new technologies and skills thereby enhancing local technological capabilities and their ability to compete on world markets.

- *Enhanced efficiency*: Opening up an economy to foreign firms increases the degree of competition in product markets thereby forcing domestic firms to allocate and use resources more efficiently.

Although FDI has enormous potential benefits, it must be recognized that they do not accrue automatically to host countries. Appropriate domestic policies—as well as supporting infrastructure and environment—are needed to enable host countries exploit the opportunities provided by FDI. The challenge to policymakers in host countries is therefore to find ways of maximizing the benefits and minimizing the costs.

The structure of the rest of the paper is as follows. Section II presents a review of recent FDI trends while section III focuses on the motives for FDI in Africa. Section IV provides explanations for low FDI in Africa and Section V outlines and examines measures to promote FDI flows to the region, with emphasis on national, regional, and international responsibilities. Section VI deals with prospects for FDI flows to the region while the last section contains some concluding remarks.

II. Recent Trends in FDI

The rapid advances in technology in the last few decades—especially in transport and communication—have led to tremendous increases in FDI. Global inward FDI flows rose from US$59 billion in 1982 to a peak of US$1,491 billion in 2000. On an annual average basis, FDI inflows increased from 23.6% in the period 1986-90 to 40.1% over the period 1996-2000. Furthermore, FDI outflows rose from 24.3% to 36.7% within the same period (Table 3).

Table 3: FDI flows 1986-2001 (Annual Growth Rate)

Item	1986-1990	1991-1995	1996-2000	2000	2001
FDI inflows	23.6	20.0	40.1	37.1	-50.7
FDI outflows	24.3	15.8	36.7	32.4	-55.0

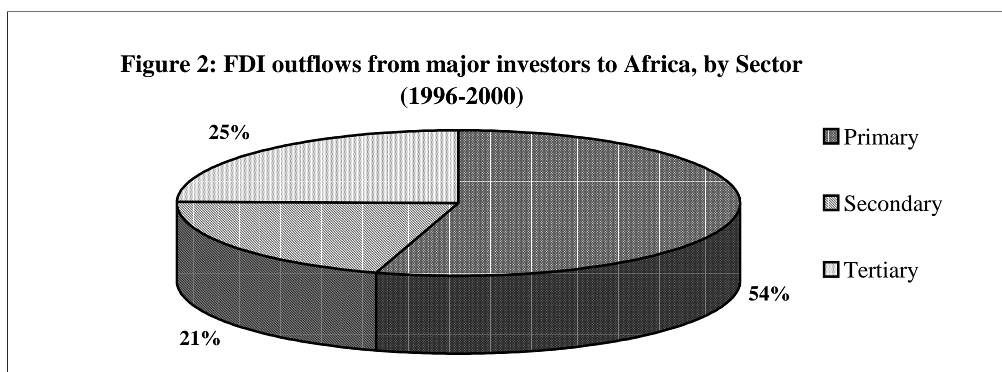
Source: UNCTAD (2002b).

In 2001 FDI flows declined for the first time since 1991, reflecting largely the slowdown in global economic activity as well as the poor performance of stock markets in the major industrial countries. FDI inflows and outflows fell by 50.7% and 55.0% respectively. This represents the largest decline in both series in the last three decades.

In 2002, global FDI flows is estimated to have dropped by 27% because of the lower than expected recovery in the global economy and the adverse effects of the auditing and accounting scandals in some advanced countries on investment decisions. In terms of regional distribution, developed countries account for the bulk of global FDI inflows (Table 2). Until the early 1990s, the share of FDI inflows to developed countries represented more than three quarters of the total flows. Since 1991, the share of developing countries has increased gradually, reaching a peak of 35.3% over the period 1993-98.

Africa has never been a major recipient of FDI flows and so lags behind other regions of the world. On an annual average basis, the region's share of global FDI inflows was 1.8% in the period 1986-90 and 0.8% in the period 1999-2000. A slight improvement was observed in 2001 when inflows to the region rose from US$9 billion in 2000 to more than US$17 billion in 2001, increasing the region's share of global FDI to 2.3%. It should be noted however that this increase was largely due to a substantial increase in FDI flows to South Africa and Morocco.[1] Within the continent, the distribution of FDI is uneven. For example, only a few countries—South Africa, Nigeria, and Angola—attracted significant inflows in 2001.

[1] South Africa and Morocco received more than 50 per cent of the total FDI flows to Africa. In the case of Morocco, the huge increase in 2001 is due to the sale of a 35 per cent stake in the local telecommunication operator, Maroc-Telecom, to France's Vivendi Universal.



Source: UNCTAD (2002b).

The primary sector remains the most important destination for FDI flows into the region, accounting for more than 50% of inflows from major investors to Africa over the period 1996-2000. Within the primary sector, oil and gas are the most important industries. Since 1999, there has been an increase in inflows into the tertiary (service) sector. In fact in 1999, the tertiary sector attracted more inflows (US$3,108 million) than the primary sector (US$2726 million). In 2000 the primary and service sectors attracted inflows worth US$2,029 and US$1931 million respectively (Figure 2).

Between 1996-2000, the US, France, the United Kingdom, Germany, and Portugal accounted for most FDI flows to Africa. Within the same period, the US is the most important source of FDI flows into Africa, accounting for approximately 37% of inflows from developed countries. This represents a marked-shift from the 1991-1995 period in which the United Kingdom and France were the most important sources of FDI flows to the region (Table 4).

African countries have serious difficulties attracting FDI flows from Japan. Tables 4 and 5 show that Japan is not a major source of FDI flows to Africa. In 2000, Africa accounted for 0.1% of total outward FDI from Japan. The figure rose to 0.6% in 2001. Since then there has been a decline. Estimates for the first half of 2002 suggest that the region accounted for just 0.2% of FDI outflows from Japan. Japanese investments in Africa are concentrated in two countries: Liberia and South Africa, with the former accounting for most of the investment in the region. There is a need for African countries to intensify efforts to market their investment opportunities to Japanese firms in order to benefit from the enormous investment resources available in Japan.

Table 4: Sources of FDI flows to Africa , 1991-2000 (Millions of Dollars)

Country	1991-1995	1996-2000
Australia	-33	-99
Austria	7	221
Belgium	-47	242
Canada	146	626
Denmark	1	340
Finland	3	8
France	2,066	4,362
Germany	402	2,475
Italy	213	678
Japan	201	340
Netherlands	297	816
New Zealand	-	-
Norway	145	-148
Portugal	96	1,560
Spain	50	476
Sweden	4	197
Switzerland	452	69
United Kingdom	2,376	3,269
United States	278	9,249

Source: UNCTAD (2002b).

Table 5: Destination of FDI from Japan, 2000-2002 (Percentage)

Region	2000	2001	2002 (first half)
North America	25.3	20.4	18.4
Latin America	10.8	24.2	13.9
Asia	12.2	19.5	15.2
Middle and Near East	0.0	0.1	0.1
Europe	50.2	33.4	45.8
Oceania	1.4	1.7	6.4
Africa	**0.1**	**0.6**	**0.2**
Liberia	0.1	0.4	0.1
South Africa	0.0	0.2	0.1
Total	100.0	100.0	100.0

Source: Website of the Ministry of Foreign Affairs, Japan.

Recently UNCTAD computed indices for the performance of economies in terms of attracting FDI inflows. The inward FDI performance index is computed as the ratio of a country's share in global FDI flows to its share in global GDP. For any given country, if the value of the index is one, this means that the country receives FDI consistent with its relative size. If the index is above one, it means that the country attracts more FDI than should be expected given its relative size. Finally, a country with an index below one attracts less FDI than should be expected given its relative size.

Table 6 shows the values of the performance index for all regions of the world over the periods 1988-90 and 1998-2000. The index varies widely between countries. It shows that developed countries receive FDI inflows consistent with their relative size (as measured by their GDP). For developing countries as a group, FDI inflows also reflect their relative size. However, the distribution among the different regions in developing countries varies widely. For the period 1988-90, countries in Africa and Latin America and the Caribbean received less inflows than their relative size while countries in Asia received more than their relative size. However, over the period 1998-2000, countries in Latin America and the Caribbean received significantly more inflows than their relative size while those in Africa and Asia received less. There was a decrease in the value of the index for Africa from 0.80 in the period 1988-90 to 0.52 over the period 1998-2000. Looking at the index at a more disaggregated level, we can observe that only one African country, Angola, appears in the top 20 while four are represented in the bottom 20 (Niger, Rwanda, Sierra Leone and Libya).

Table 6: Inward FDI Performance Index by Region, 1988-2000

Region	1988-1990	1998-2000
World	1.00	1.00
Developed countries	1.01	1.00
Developing countries	0.99	0.99
Africa	**0.80**	**0.52**
North Africa	0.84	0.42
Other Africa	0.77	0.60
Latin America and Caribbean	0.91	1.37
Asia	1.07	0.85
Central and Eastern Europe	0.89	0.98

Source: UNCTAD (2002b).

UNCTAD has also developed FDI potential indices for several economies in the world for the period 1998-2000. The index is an unweighted average of the normalized values of the following variables: the rate of growth of GDP; per

capita GDP; the share of exports in GDP; telephone lines per 1,000 inhabitants; commercial energy use per capita; share of R&D expenditures in gross national income; share of tertiary students in the population; and country risk. Of the 35 African countries included in the sample, only 3—Namibia, Botswana, and Egypt—had very high FDI potential, and Namibia was the only country in the region with both high FDI performance and potential (Table 7).

Table 7: Classification of African Countries by Performance and Potential (1998-2000)

	High FDI performance	**Low FDI performance**
High FDI potential	Front runners Namibia	Below potential Botswana, Egypt
Low FDI potential	Above potential Angola, Côte d'Ivoire, Gambia, Malawi, Mozambique, Sudan, Uganda, Zambia	Under-performers Algeria, Benin, Burkina Faso, Cameroon, Dem. Rep. of the Congo, Congo, Ethiopia, Gabon, Ghana, Guinea, Kenya, Libya, Madagascar, Mali, Morocco, Niger, Nigeria, Rwanda, Senegal, Sierra Leone, South Africa, Tanzania, Zimbabwe

Source: UNCTAD (2002b).

Despite the poor performance of the African region in terms of FDI flows, it should be stressed that several countries have made progress in attracting FDI in the last few decades. These include, Botswana, Mauritius, Mozambique, Uganda, Lesotho, Namibia and Swaziland.

III. Motives for FDI in Africa

There are two types of investments made by foreign investors in host countries: greenfield investments which involve investment in a new establishment; and cross-border merger and acquisition (M&A) of an existing local firm. In general, these investors are driven by the desire to make profit. However, they are also attracted by other factors such as the desire to:

- Exploit natural resources: as in Nigeria, Angola, Botswana, and Namibia;

- Take advantage of location: as in Lesotho and Swaziland;
- Reap the benefits of domestic investment incentives: as in Mauritius and Seychelles;
- Respond to economic policy reforms, especially privatisation: as in Mozambique and Uganda.

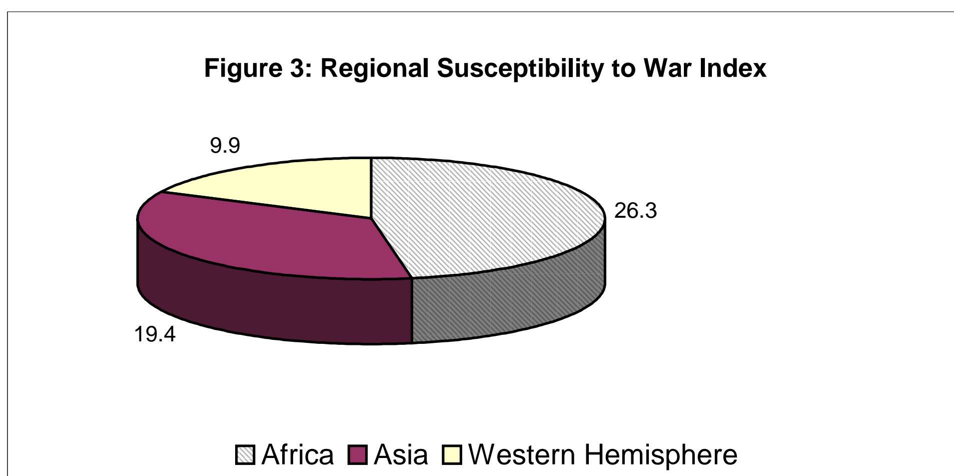
IV. Reasons for low FDI in Africa

It is a well-known fact that Africa lags behind other regions in FDI flows. Various explanations have been adduced for this phenomenon ranging from political and macroeconomic instability to inhospitable regulatory frameworks and weaknesses in infrastructure provision, governance, and institutions in general. What is lacking in the literature is reliable evidence on the relative contribution of these factors in different countries. Unfortunately, the paucity as well as the poor quality of African data makes it difficult to conduct any serious and reliable empirical study on the issue. Consequently, in this section we simply provide and examine the major factors that militate against the attraction of significant FDI flows to the region.

Uncertainty: One of the reasons why foreign investors are reluctant to invest in Africa despite its enormous profitable opportunities, is the relatively high degree of uncertainty in the region, which exposes firms to significant risks. Uncertainty in the region manifests itself in three different ways:

- Political instability: The region is politically unstable because of the high incidence of wars, frequent military interventions in politics, and religious and ethnic conflicts. There is some evidence that the probability of war—a measure of instability—is very high in the region. In a recent study, Rogoff and Reinhart (2002) computed regional susceptibility to war indices for the period 1960-2001. They found that wars are more likely to occur in Africa than in other regions (Figure 3). The regional susceptibility to war index is 26.3% for Africa compared to 19.4% and 9.9% for Asia and the Western Hemisphere respectively.

Figure 3: Regional Susceptibility to War Index



Source: Rogoff and Reinhart (2002).

- Macroeconomic instability: Instability in macroeconomic variables as evidenced by the high incidence of currency crashes, double digit inflation, and excessive budget deficits, has also limited the regions ability to attract foreign investment. Table 8 shows that there is a statistically significant negative correlation between inflation and FDI. Countries with high inflation tend to attract less FDI.

Table 8: FDI to Africa, Selected Correlations

FDI and Conflict	-0.31*
FDI and Inflation: CFA countries	-0.23*
FDI and Inflation: Non CFA countries	-0.17**
FDI and the Probability that the parallel market premia is above 50 per cent	-0.36*

Source: Rogoff and Reinhart (2002).
Notes: An asterisk (*) denotes significance at the 5 per cent level while a Double asterisk (**) indicates significance at the 10 per cent level.

- Lack of policy transparency: In several African countries it is often difficult to tell what specific aspects of government policies are. This is due in part to the high frequency of government as well as policy changes in the region and the lack of transparency in macroeconomic policy. The lack of transparency in economic policy is of concern because it increases transaction costs thereby reducing the incentives for foreign investment.

Inhospitable Regulatory Environment: The lack of a favourable investment climate also contributed to the low FDI trend observed in the region. In the past, domestic investment policies—for example on profit repatriation as well as on entry into some sectors of the economy—were not conducive to the attraction of FDI (Basu and Srinivasan, 2002). Some progress has been made in this area in the past few years but more needs to be done.

Poor Infrastructure: The absence of adequate supporting infrastructure: telecommunication; transport; power supply; skilled labour, discourage foreign investment because it increases transaction costs.

Market Size: Relative to several regions of the world, domestic markets in Africa are quite small. This makes it difficult for foreign firms to exploit economies of scale and so discourages entry.

Corruption and Weak Governance: Weak law enforcement stemming from corruption and the lack of a credible mechanism for the protection of property rights are major deterrents to FDI in the region. Foreign investors prefer to make investments in countries with very good legal and judicial systems to guarantee the security of their investments.

High Dependence on Commodities: Several African countries rely on the export of a few primary commodities for foreign exchange earnings. Because the prices of these commodities are highly volatile, they are highly vulnerable to terms of trade shocks and this results in high country risk thereby discouraging foreign investment.

Increased Competition: Globalisation has led to an increase in competition for FDI among developing countries thereby making it even more difficult for African countries to attract new investment flows. Relative to other regions of the world, Africa is regarded as a high-risk area. Consequently foreign investors are reluctant to make new investments in—or move existing investments to—the region. The intensification of competition due to globalisation has made an already bad situation worse. It must be pointed out that the intense competition resulting from trade and financial liberalization puts African countries at a disadvantage because they have failed to take advantage of the globalisation process—for example, through deepening economic reforms needed to increase their competitiveness and create a supportive environment for foreign investment.

Poor and Ineffective Marketing Strategy: In the past, African governments set up agencies to promote foreign investment without taking adequate steps to lift the

constraints on foreign direct investment in the region. It is therefore not surprising that investment promotion activities in the region have not been as successful as expected. For example, in Nigeria, FDI promotion in the 1990s was accompanied by increased political risk: frequent and abrupt changes in government; religious and ethnic conflicts; and border disputes. In Ethiopia, until recently, promotion activities went hand in hand with the intensification of war with Eritrea. Similar inconsistencies between government promotion activities and domestic political developments can be found in other African countries but the two examples given here are sufficient to illustrate our point. Apart from the idea that promotion activities in the region started earlier than necessary, there is also the problem that Investment Promotion Agencies (IPA) created by domestic governments were highly bureaucratic, expensive to maintain, and have not been successful in reversing the declining trend in FDI flows to the region.

V. Promotion of FDI to Africa

One of the development challenges facing African leaders today is how to attract FDI to the region. A number of efforts have been made in the past to boost FDI flows to the region but they have not had any significant impact. These efforts were unsuccessful because they were ill conceived, did not lift underlying constraints on FDI to the region, and failed to confront the challenges to the attraction of FDI to the region posed by the globalisation process.

In designing policies and measures to promote foreign investment and reverse the current dismal FDI trend in Africa, it is important to recognize three facts. First, FDI requires a long term commitment to the host country, involves very high sunk costs and, in the short-run, it is difficult for foreign investors to recoup their initial investments if there is a sudden change in the degree of risk associated with their location. The implication of this short-run irreversibility of FDI is that decisions on entry into a host country are highly sensitive to uncertainty about the investment environment.

Second, foreign investors regard Africa as a high-risk investment region. In addition, economic and political risks are highly contagious due in part to the interdependence of African economies and the globalisation of the world economy. The interdependence of African economies affects investors' assessment of risk in individual countries. Because of imperfect information, foreign investors associate the outbreak or occurrence of risk in one country with the likelihood of similar risks in other countries in the region. Consequently, for the most part, they do not differentiate between countries in the region—a

phenomenon known as statistical discrimination. This implies that an increase in political instability in one African country will diminish the probability of foreign direct investment flows to that country as well as to other countries in the region. The possibility of statistical discrimination, herding in investment behaviour due to contagion, and the absence of adequate instruments for hedging in the region, suggests that complete reliance on a country-specific approach to the reduction of political risk in the region cannot be effective in reducing foreign direct investors' perception of risk in the region. What is needed is a regional approach that recognizes the interdependent nature of African economies and the fact that economic and political risks are contagious.

Finally, the intensity of competition for FDI among developing countries has increased with globalisation. Most developing countries have recognized this fact and are taking, or have taken, steps to adapt to the changing external environment. The implication of this increase in competition for FDI is that African countries need to have comprehensive, as opposed to selective, policy reforms if they are to attract FDI to the region.

That said, successful promotion of FDI to the region requires actions at the national, regional, and international level. More specifically, the following measures are needed to promote and attract FDI to Africa.

Domestic actions

Domestic actions involve actions to be taken by countries in the region: These include image-building, domestic regulatory reforms, and marketing of investment opportunities.

Image building: Improving the currently bad image of the continent is key to reversing the dismal FDI trend of the region. This requires an increase in:

- Political stability
- Macroeconomic stability and
- The protection of property rights as well as the rule of law

Supporting existing investors: Improving the investment climate for existing investors through infrastructure development; provision of services and changes in the regulatory framework—relaxing laws on profit repatriation etc—will encourage them to increase their investments and also attract new investors.

Marketing investment opportunities: Creating awareness of investment opportunities through: existing investors; and the use of information communication technologies such as the internet. Experience has shown that reliance on IPAs for investment promotion has not been very effective in the African region, so there is the need for a shift of emphasis from IPAs to existing investors. This is also relevant because studies have shown that existing investors play a very important role in attracting new investors to new investment locations. In a recent study of foreign direct investor perceptions conducted by the United Nations Industrial Development Organisation (UNIDO) in four African countries—Ethiopia, Uganda, Nigeria, and Tanzania—existing investors were found to be responsible for roughly 50% of investor awareness of investment opportunities (UNIDO, 2002).

Diversification of the economy: Several African countries rely on the export of a few primary commodities for foreign exchange earnings. This exposes them to significant terms of trade shocks. Diversification of the economy will enable them to cushion the effects of these shocks and reduce country risk.

Trade liberalisation: Openness to trade will signal commitment to outward-looking, market-oriented policies and enhance trading opportunities thereby attracting foreign investors intent on taking advantage of the new trading opportunities.

Privatisation: The privatisation of inefficient state-owned enterprises will boost foreign investment. African countries have now recognized that the privatisation of public corporations is necessary to reduce government fiscal deficits and several countries have instituted privatisation programs. However, progress in the privatisation of enterprises has been slow in several countries because of domestic political pressure by powerful interest groups that are against the process.

Regional actions

Specific actions to be taken at the regional level fall under the following categories: market size; agency of restraint; promoting good governance; and infrastructure development.

Market size: Enhanced regional integration will increase market size in the region and help attract investors currently constrained in part by the small size of domestic markets in the region.

Agency of restraint: Regional integration through the formation of regional groupings can also be used to reduce the incidence of domestic policy reversals and improve the credibility of economic policies in the region. The point here is that in an environment in which national governments have a credibility problem, regional groups can provide an external agency of restraint on domestic policies.

Promoting good governance: The use of a regional surveillance mechanism based on peer pressure will promote good governance and improve the investment climate.

Infrastructure development: Initiating and encouraging more cooperation in infrastructure development projects—for example, in telecommunication, transportation, power generation, and the provision of water—at the regional level. This will increase access to and reduce the cost of provision of these facilities, thereby lowering transactions costs, boosting trade, and increasing the attraction of the region to foreign investors.

International actions

International actions involve improving market access and assistance in investment promotion as well as in capacity building and infrastructure development.

Improved market access: through the elimination of trade barriers and unfair subsidies on agricultural goods exported by African countries will enhance trading opportunities in the region and create an incentive for foreign investors to invest in the region. Some attempts have been made recently by developed nations to improve market access for African countries. These include:

- The African Growth and Opportunity Act (AGOA) introduced by the United States in 2000. The act gives most African countries preferential access to US market for petroleum products, agricultural goods, and manufactures such as textiles. Exports of goods covered by the act from Madagascar, Nigeria, Gabon, South Africa, Lesotho, and Swaziland have already increased as a result of this scheme. While the act gives African nations an advantage over other regions, it does not cover all exports from Africa and so its potential benefits to the region will be limited.

- The “Everything-but-Arms” initiative approved by the European Union in February 2001 with the objective of eliminating quotas and duties on all

goods, except arms, from 49 least developed countries, most of which are in Africa.

Despite the progress made so far, it must be stressed that these initiatives do not go far enough and more needs to be done by the international community to improve market access for African countries. Recent evidence indicate that about 40% of the costs of trade barriers to developing countries are due to restrictions imposed by developed countries (Anderson et. al. 2001). Furthermore, there is evidence that the elimination of trade barriers and unfair subsidies on agricultural goods by the European Union, the United States, Japan, and Canada will increase Sub-Saharan Africa's non-oil exports by 14% and income by 1% (Ianchovichina et. al. 2001).

Investment promotion assistance: Since African countries are poor, and investment promotion is costly, governments of developed countries can assist the region in investment promotion through providing accurate information to investors in their countries about the investment environment and opportunities in the region. This type of investment promotion is likely to be more effective than the current approach used by African countries because investors in developed countries take the information received from their governments more seriously than those from developing countries.

Technical assistance: Developed countries can also help improve investment conditions in the region and increase its attraction to foreign investors by providing more technical assistance in areas such as: capacity building, infrastructure development, health and education.

VI. Prospects

Despite the dismal FDI record of African countries, there is room for optimism because recent developments in the region in the last few years signal a change in attitude towards more openness to FDI flows. More specifically, we believe that there will be modest improvements in FDI flows to the region in the short to medium term because of the following:

- FDI policies in Africa are improving—profit repatriation is now permitted in most countries, tax incentives are commonplace, there is an increase in the number of industries open to FDI, and privatization and trade liberalization are gaining widespread acceptance in the region. These developments would improve the investment climate.

- There are improvements in telecommunications infrastructure made possible by privatization programmes and this has reduced transactions costs.

- Cessation of hostilities in a number of African countries and an increase in the number of democratic regimes. This would reduce political instability and increase future FDI flows due to lagged effects.

- Recently, African leaders designed a framework for development in the region—known as the New Partnership for African Development (NEPAD)—that emphasizes the need for macroeconomic stability, good governance, peer review, and political stability in the region. If the principles enshrined in the NEPAD documents are taken seriously and implemented by African leaders, there is the distinct possibility that this may change the quality of economic policy-making in the region and improve the investment climate.

Although we are optimistic about the future prospects for FDI in the region, it should be noted that not all countries are likely to attract significant flows in the future. The nature of domestic institutions and economic policies will ultimately determine the set of countries that will have success in the attraction of FDI in the near-to-medium term. Based on recent surveys of investment strategies of a number of transnational corporations, the prospects for FDI in the medium-term are best for South Africa, Egypt, Morocco, Nigeria, and Angola. Most firms surveyed indicated that these are their preferred economies for investment in the medium term (Tables 9 and 10). That said, we believe that countries such as Mozambique, Uganda, Tanzania, Namibia, Mauritius, and Botswana, are also likely to experience an increase in FDI flows because of the relative improvement in their economic policies in the last few years.

Table 9: Expected changes in mid-term prospects for FDI by region

(percentage of respondents)

Prospects	North America	European Union	Japan	North Africa and Western Asia	Sub-Saharan Africa
Worse	3	7	6	14	11
Unchanged	57	44	69	79	74
Improved	38	45	23	6	14
Significantly improved	2	4	2	0	1
Total	100	100	100	100	100

Source: Website of Invest in France Agency.

Table 10: Favored economies by region

Developed countries		Africa and Western Asia	
United States	27	South Africa	17
Germany	16	Egypt	12
United Kingdom	12	Turkey	8
France	10	Morocco	8
Italy	6	Nigeria	6
Japan	5	Saudi Arabia	6
Spain	5	United Arab Emirates	5
Sweden	3	Israel	2
Canada	3	Angola	2
Ireland	2	Other	4
Other	13		

Source: Website of Invest in France Agency.

The results of the investment surveys also suggest that exports are the preferred form of expansion by transnational corporations in Africa. For developed countries the preferred form is mergers and acquisitions and for developing countries as a group, it is greenfield investment (Table 11).

Table 11: Favored form of expansion by host region
(percentage of respondents)

Form of expansion	Developed countries	Developing countries	Africa and Western Asia
Mergers and acquisitions	37	19	12
Greenfield or expansion	22	27	22
Strategic alliances	24	22	13
Licensing or franchising	7	5	7
Exports	9	24	41
Other	2	3	4
Total	100	100	100

Source: Website of Invest in France Agency.

In addition to natural resources, we believe that the sectors that present the best future opportunities for foreign investment in the region are utilities and infrastructure. At the moment, the public sector provides most of these services,

but there is growing recognition of the fact that they can be better and more efficiently provided by the private sector. If the current wave of privatization sweeping through the continent continues unabated, there will be an increase in the number of public utilities marked for privatisation in several African countries.

Concluding remarks

FDI can play an important role in the development efforts of the region. To date, African countries have not been successful in attracting significant FDI flows, reflecting largely the combined effects of political and macroeconomic instability, weak infrastructure, poor governance, inhospitable regulatory environments, intensification of competition for FDI flows due to globalisation, and poor marketing strategies. There is the need to reverse the declining FDI trend in the region. This requires concerted efforts at the national, regional, and international level. It also requires a new and more effective approach to investment promotion.

In the past, investment promotion activities in the region were carried out in an environment in which domestic policies were by and large not conducive to foreign investment and so were not successful. An enabling environment has to be created first before marketing investment opportunities to foreign entrepreneurs could be done effectively. The maintenance of a sustained political and macroeconomic policy environment would get the region closer to attaining this objective. Furthermore, the realization of Africa's FDI potentials will also depend on the ability of its leaders to improve the FDI climate and take advantage of the new global interest in the affairs of the region by implementing sound macroeconomic policies, enforcing the rule of law, reducing risks of policy reversals, and improving the provision of infrastructure.

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