AFRICA LABOUR RESEARCH NETWORK

# FOREIGN DIRECT INVESTMENT IN AFRICA

Ntwala Mwilima
Labour Resource and Research Institute (LaRRI)

SEPTEMBER 2003

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# 1. Introduction

This introductory chapter forms part of the pilot phase of a Social Observatory Project that will monitor the conduct and impact of foreign investors in Africa. Section 1 the introduction aims to set out what foreign direct investment (FDI) is and to define the two forms in which it occurs. The second section will look at why Africa perceives FDI as important and examine the initiatives undertaken by African governments in attracting FDI. Section 3 will focus on the factors that influence/determine where FDI flows and why. Section 4 discusses the actual flows of FDI in terms of regions and sectors. The fifth section will deal with the costs and benefits associated with FDI while the last section contains the conclusion and recommendations regarding African policies on FDI.

## 1.1 What is FDI?

Foreign Direct Investment is viewed as a major stimulus to economic growth in developing countries. Its perceived ability to deal with major obstacles such shortages of financial resources, technology, and skills. This has made it the center of attention for policy makers in developing countries such as Africa. FDI refers to investment made to acquire a lasting management interest (usually at least 10 % of voting stock) and acquiring at least 10% of equity share in an enterprise operating in a country other than the home country of the investor. FDI can take the form of either “greenfield” investment (also called "mortar and brick" investment) or merger and acquisition (M&A), depending on whether the investment involves mainly newly created assets or just a transfer from local to foreign firms.

Most investment have taken the form of acquisition of existing assets rather than investment in new assets ("greenfield"). M&As have become a popular mode of investment of companies wanting to protect, consolidate and advance their positions by acquiring other companies that will enhance their competitiveness. Mergers and acquisitions are defined as the acquisition of more than 10% equity share, involve in transfer of ownership from domestic to foreign hands, and do not create new productive facilities. Based on this definition, M&As raise particular concerns for developing countries, such as the extent to which they bring new resources to the economy, the denationalization of domestic firms, employment reduction, loss of technological assets, and increased market concentration with implications for the restriction of competition.

Research conducted by UNCTAD for the World Investment Report 2000 revealed that, for the host country, the benefits of M&As are lower and the risks of negative effects are greater when compared to Greenfield investments, especially at the time of entry over the short term. An UNCTAD research on M&As concluded that:

- FDI through M&As correspond to a smaller productive investment than Greenfield as the financial resources do not necessarily go into increasing the capital stock,
- FDI through M&As is less likely to transfer new or better technologies than Greenfield investment,
- FDI through M&As do not generate employment at the time of entry into the host economy, and may lead to lay-offs as the acquired firm is restructured,
- FDI through M&As can reduce competition, and may be used deliberately to reduce or eliminate competition and
- Over the longer term, cross-border M&As are often followed by sequential investment that do increase the capital stock.

Ideally the purpose of investment is to benefit both the investing company and the host economy. However M&As are likely to result in profit for the investing firm but destruction of the domestic industry. Evidence shows that in some cases, foreign investors enter a market solely with the purpose of closing down domestic competitors and establishing a monopoly in the economy. The most noteworthy policy mechanism against such practices and which also serves to protect the domestic economy is a competition policy.

### 1.2 Competition policy

A competition policy is central to ensuring the effective operation of the market. The main purposes of a competition policy are to oversee the efficient allocation of resources and to ensure consumer welfare. In the absence of a competition policy, markets that are open to private business, face the danger of firms engaging in monopolistic and restrictive trade practices. The basic importance of a competition policy lies in its ability to assess the competitive impact of mergers and acquisitions, and to regulate the behavior of firms (CUTS, 2001).

Mergers and acquisitions have a serious impact on competition and markets all over the world. In sub-Saharan Africa, almost all FDI in the form of M&As takes place in South Africa. It is reported that approximately 60% of inward investment in South Africa takes the form of mergers and acquisitions. A recent KPMG study revealed that South Africa recorded a total of US$ 7.6bn of cross border inward and outward M&As since June 2000. South Africa has a very low rate of greenfield FDI. Most FDI inflows in South Africa are capital intensive and are directed at the already established sectors such as services and manufacturing.

The Central Bank of Chile (CBC) has indicated that there is a close relationship between greenfield and M&A FDIwhich is based on that once a transnational corporation (TNC) has established a subsidiary through cross-border M&A, all financial transfers thereafter between headquarters and the subsidiary are regarded as greenfield. The CBC cautions that this relationship is not mechanical, and does not necessarily imply a positive relationship between both types of FDI (Central Bank of Chile, 2002).

## 2. WHY FDI IS SEEN AS IMPORTANT FOR AFRICA

The Economic Report on Africa by the United Nations Economic Commission for Africa advocates that FDI is the key to solving Africa's economic problems. Bodies such as the IMF and the World Bank have suggested that attracting large inflows of FDI would result in economic development. Sub–Saharan African governments are very eager to attract FDI. They have changed from being generators of employment

and spillovers for the local economy to governors of states that promote competition and search for foreign capital to fill the resource gap. This change is attributed to changes that are caused through structural adjustment programmes and the internalization of neo-liberal assumptions promoted by the World Bank and IMF.

All African countries are keen on attracting FDI. Their reasons would differ but may be summarised as: trying to overcome scarcities of resources such as capital, entrepreneurship; access to foreign markets; efficient managerial techniques; technological transfer and innovation; and employment creation. In their attempts to attract FDI, African countries design and implement policies; build institutions; and sign investment agreements. These benefits of FDI to African countries are difficult to assess but will differ from sector to sector depending on the capabilities of workers, firm size, and the level of competitiveness of domestic industries.

In Southern Africa, the main five reasons governments want to attract FDI are:

- FDI is seen as an important source of capital formation particularly when the capital base is low. Capital inflow is seen as a way of creating a surplus in the capital account of the balance of payments or to make up for the deficit on the current account. Consumer Unity and Trust Society (CUTS) points out that there has been cases where FDI have not led to capital formation but rather crowded out domestic investment ( Chatterjee, undated),
- Transfer of technologies is expected because foreign companies will use technology from their home country. From a developmental perspective, it is more important that technology is diffused with spill- over into the local production process, and that technology be adopted and adapted by local enterprises. For an economy to improve on quality, technological upgrading is crucial. Technical inefficiency, in developing countries, can severely hinder the quality of products produced and the ability to cope with new demands. At the moment, no studies have shown that FDI had this diffusion-effect in Southern Africa. On the contrary, foreign investment results in competition that tends to stifles local technology development and diverts resources from technology development to attracting FDI.
- It is argued that FDI will lead to employment creation. International experience shows that foreign direct investment is not always accompanied by substantial employment creation and in most cases lead to job losses when public companies are privatised. In a special ECONEWS report on Foreign Investment in SADC, it was pointed out that “FDI is not a good way to create jobs”. While a quarter expands employment, a third will contract employment. For example, in Namibia, most FDI investments went into the mining industry that reduced its workforce from 14000 to 5000 during the past 12 years.
- Transfer of management skills, to local managers, takes place when investors set up new plants, acquire companies or outsource to local subcontractors.. .
- Increased export competitiveness is anticipated. This was an important argument when South Africa introduced its Growth, Employment, and Redistribution (GEAR) strategy. It emphasized the importance of attracting investment in clusters of industries to develop local companies.

A closer analysis of the main reasons for attracting FDI, employment creation and capital formation, don’t really have the desired effect.

- Employment creation: International experiences have shown that FDI is hardly accompanied by substantial employment creation, and in some cases may even lead to job losses. Another problem with employment through FDI is the kind of employment it creates. In Namibian, for example, the government claimed that

the Export Processing Zone (EPZ) programme created jobs and thus reduced the unemployment rate. However, the jobs that were created are mostly characterized by poor working conditions and very low salaries. Most of the employees do not have job security and little prospects of improving their standards of living. It is thus important to examine the quantity and quality of jobs created.
- Capital Formation: Yash Tandon argues that any reasonable accounting of capital flows must take into account what flows in and out of the country (Tandon, 2002). In the Investment Position Paper by COSATU, it was pointed out that FDI flowing out of South Africa had increased rapidly, and since 1994, it has exceeded direct capital flows. COSATU has indicated that between 1994 and 2000, FDI into the country came to R45 billion, while outflows of direct investment came to R54 billion (COSATU, 2001).

## 2.1. Initiatives taken by African countries to attract FDI
African countries, like most other developing countries have taken various initiatives to attract FDI. These initiatives include incentives, signing of investment treaties and investment promotion activities.

### 2.1.1 Incentives
Incentives can be described as policies used to attract internationally mobile investors. Through the EPZ programme, African countries offer incentives to attract foreign investment in the form of tax holidays, exemptions on export and import duties, subsidized infrastructures, and limits on workers rights. According to Jauch and Endresen (2000), opinions about the importance of incentives vary significantly. Governments consider them as a mean to obtain FDI whereas transnational corporations perceive EPZs as providers of favourable investment sites. The case of Namibia is instructive in this regard.

In 1995, Namibia passed it's EPZ Act. Four years later, LaRRI carried a study to assess the socio-economic impact of Namibia's EPZ programme. This study revealed that Namibia had come short of the expectation in terms of the EPZ programme. The government anticipated creating 25 000 jobs by the end of 1999. The actual number of jobs created at the time of the study was 400. The study carried out by LaRRi unraveled poor labour conditions that could lead to future conflicts (LaRRI, 2000). This prediction was confirmed in 2002-2003 when RAMATEX, a Chinese owned textile company producing for the US market from Namibia had two strikes within months of each other. The reasons were poor working conditions and poor salaries, typical conditions that prevail in EPZs.

African countries have improved their regulatory frameworks for FDI by opening their economies, permitting profit repatriation and providing tax and other incentives to attract investment. Improvements in the regulatory framework for FDI have been stressed in many countries through the conclusion of international agreements on FDI. Most African countries have concluded bilateral investment treaties with countries whose main aim is the protection and promotion of FDI. They also clarify the terms under which FDI can enter the host country (UNCTAD; 1999;P.6).

Since the 1980s, all SADC governments have relaxed regulations for foreign investors:
- By granting investors easier entry,
- By relaxing the ability to borrow locally although it implies a constraint on a country's foreign currency reserves,
- Relaxation of land and mining concession ownership,

- By forming new kinds of partnerships with the private sector (public private partnerships) in areas which were previously the responsibility of the government e.g. water distribution.

The incentives offered by governments can be grouped into three categories such as fiscal, financial and rule or regulatory-based:

**Fiscal Incentives**
- Reduced tax rates
- Tax holidays,
- Subsidies,
- Exemptions from import duties
- Accelerated depreciation allowances
- Investment and reinvestment allowances
- Specific deductions from gross earnings for national income tax purposes
- Deductions from social security contributions

**Financial Incentives**
- Grants
- Loan and loan guarantees

**Rules-based incentives**
- Modifying rules on worker's rights
- Modifying environmental standards
- Greater protection for intellectual property rights (CUTS, 2001)

**2.1.2 Investment treaties**

Incentives are only a part of what governments offer to attract foreign investors to their countries for investment. Increasingly countries have entered into investment treaties, both bilateral investment treaties and multilateral ones.

- Bilateral investment treaties

The bilateral treaties contribute to the establishment of favourable investment climate between two countries by providing assurance and guarantees to investors. In the SADC region, only South Africa did not have a law that specifically dealt with FDI by the late 1990s. More and more bilateral treaties are being signed by African countries to safeguard the rights of the investors. Bilateral investment treaties are perceived as contributing to the establishment of favourable investment climate because they include the following:

- Fair and equitable treatment for foreign investors in terms of applications for investment approval and setting up their businesses,
- Specific provisions on expropriation and non-commercial losses and compensation for the same, and
- Dispute or conflict settlement mechanism (CUTS, 2001).

**2.1.3 Investment Promotion**

More and more countries are engaging in pro-active policies to attract FDI. Most countries have established investment promotion agencies (IPA) whose main purpose is to attract FDI and to look after foreign firms once they have set operations. Many countries, particularly in Africa, still suffer from a negative image. This makes the marketing role of IPAs extremely important. Investment promotion agencies usually fulfill a dual role:

- By acting as a one stop for investors to deal with regulatory and administrative requirements, and

- By changing or modifying investor perception of the country by attending and organizing investor fairs and by distributing materials.
- Investment promotion covers a range of activities, including investment generation, investment facilitation, aftercare services, and policy advocacy to enhance the competitiveness of a location.

According to the World Investment Report (2002) the majority of countries have moved from the first generation of investment to the second generation of investment. First generation investments mainly involve the opening up of an economy to FDI whereas second generation investment actively involves a government in marketing its location by setting up investment promotion agencies.

- In order to increase the efficiency of investment generation and enhance the chances of attracting export-oriented FDI, some IPAs go further and utilize part of their FDI promotion resources for investor targeting. Third generation promotion can be an efficiency policy tool, but it is not an easy task and involves certain risks, such as, the process of investor targeting does not integrate with the overall development strategy of a country. |Other risks involve utilising resources which may be focused on seeking investments that do not materialize; attracting the wrong types of firms; and assuming the government's ability to foresee which types of FDI are likely to have the greatest ability to integrate and link with local investment (WIR, 2002).Such risks necessitates that investment promotion agencies work closely with other parts of government to identify and create comparative advantages that are sustainable and that developmental policies do not offset each other.. Targeting needs to be a continuous process and should not be taken as a once off initiative.

## 2.2 A targeted approach to FDI

According to the WIR (2002) targeting can be defined in different ways. In principle, it involves the focusing of promotional resources to attract a defined sub-set of FDI flows, rather than FDI in general. Some countries i.e. Singapore, Ireland and The Netherlands, have practiced targeting export-oriented FDI for some time, with success. However, it is only recently that targeting has become a more widely accepted tool among IPAs. The WIR (2002) identifies some reasons as to why some countries have adapted the targeting approach to attract export-oriented FDI:

- First and foremost, a targeted approach can help countries achieve strategic objectives related to such aspects as employment, technology transfer, exports and cluster development which are in line with their overall development strategies. Effective targeting involves a comprehensive approach to attracting investment that can contribute to development and enhance the competitiveness of a location. It also requires the adoption of government policies that underpin the specific marketing activities and coordination of the relevant government agencies, including IPA, in order to define investment priorities and the package of advantages offered in the framework of an overall development strategy,
- A second reason for engaging in investor targeting,that attracts export-oriented FDI, is the increased competition for this kind of investment. Due to the fact that some countries are better known to foreign investors in their capabilities to offer substantial domestic markets, the smaller less well-known economies have to work twice as hard in their targeting efforts, and
- A third reason relates to cost-effectiveness. A focused approach to attract export-oriented investment is likely to be less costly than the one in which an IPA tries to attract new investments in all sectors at the same time.

Once an IPA has decided to use targeting as part of its strategy to attract export-oriented FDI, the next challenge is to determine what industries; activities; countries; companies and individual managers should be targeted. The starting point of the selection process is careful assessment of the strengths of a location as a base for export production.

The recent trend amongst countries to liberalize investment policies in all respects may not allow them to reap the full benefits from investment. In countries like Taiwan and Korea, targeted investment policies placed requirements on investments to ensure the transfer of skill and technology. Similarly other successful newly industrialized countries also controlled the amount of investment in particular sectors, time periods and the balance between direct investment and portfolio investment.

## 2.3 Precautions when formulating policies to attract FDI

The Consumer Unity and Trust Society (CUTS) of India suggested that governments should replace burdensome regulations with good regulations that will support a country's development aims. This should include maintaining restrictions on capital flows, maintaining screening procedures and impact assessments prior to establishment for major projects, restricting investment in key strategic sectors and requiring firms to follow good standards in the operational phase. Governments should also try and create an enabling environment. The term "enabling environment" has been coined to include legal, political, social and economic factors that make a country an attractive destination for investment. . According to CUTS, these include:

- Stability and transparency

It is pointed out that social and political stability of a country plays a very important role in determining whether investors will consider investing in a country. Countries experiencing civil unrest and political upheaval are unlikely to be considered as investment destinations.. However, the relationship between investment and political stability is complex. It is argued that there are cases in which foreign companies operating in developing countries may be involved in fostering instability for commercial gain (CUTS, 2001).

Transparency in decision-making is another important issue. Investors, seeking sites for long-term investment for large-scale production to serve regional and global markets, attach great importance to the predictability of the operating environment of their chosen investment sites.

A system based on incentives negotiated on a deal-by-deal basis may appeal to some investors as well as to some government officials. However due to the possibilities of arbitrariness and corruption, most investors will prefer and profit more, in the long run from the stability, transparency and predictability of a rule-based approach to FDI policy. The key to attracting FDI is timely review and constant monitoring of results, the ability to change policies and adapt to new circumstances. The policies should not be changed arbitrarily or too frequently as investors attach importance to stable regimes.

- Macroeconomic policies

Within the context of a stable and transparent economic and regulatory environment, the main determinants of investor's decisions are broad macroeconomic factors such as the size and growth of the market and the costs of production. Governments should therefore put in place sound macroeconomic policies that will help the country achieve development objectives as well as helping the country to attract FDI (CUTS, 2001).

- Trade policy

The trade regime in a country may encourage enterprises, local and foreign, to invest in developing local capabilities. A highly protected regime or a large regime with very restrictive laws will put constraints on the entry and exit of local enterprises, discourages technological upgrading, and isolate the economy from international trends. Liberalizing the trade regime will encourage and bring competition in the economy, forcing domestic firms to improve efficiency (CUTS, 2001).
According to CUTS, trade barriers should not be lifted immediately after liberalisation so as to allow domestic industries in key sectors to achieve a certain scale before opening up to competition in the world market. Regional trade agreements enlarge the potential market for investors and therefore act as an investment magnet. Small, isolated economies can overcome their disadvantages in respect to market size by entering into such agreements. Regional initiatives may take the form of free trade areas and customs unions, depending on the level of regional cooperation. Efforts to improve regional infrastructure networks, for example, roads or electricity, can also lure foreign investors by easing access to markets. Regional free trade agreements increasingly include provisions for free trade investment. Yash Tandon disagrees with the theory that free trade is beneficial. He points out that the idea of a free market is a myth. He stipulates that the bargaining and negotiations in the WTO show clearly that the Northern countries protect the weaker parts of their economy and liberalize the stronger sectors (Tandon, 2002).

# 3. FACTORS INFLUENCING INVESTOR DECISIONS

It is argued that a strong policy and regulatory regime, appropriate institutions, good infrastructure, and political and economic stability are important to attract FDI. According to Ludger Odenthal from UNCTAD, business has indicated different determinants for decisions to invest abroad. Some of these determinants are:

- The policy framework for FDI such as political and social stability, rules about treating operations of affiliates of foreign companies, and international FDI agreements.
- Economic determinants such as the size of the market and per capita income.
- Economic determinants for FDI that seeks natural resources.
- Economic determinants which are relevant for FDI that seeks efficiency, such as cheaper costs for infrastructure or intermediate products.
- Business affiliation provisions such as investment incentives which are mostly considered to be important determinants but they are not, except in case of choice between two equally attractive locations.
- Privatization programmes have become a source for attracting FDI (Odenthal, 2001).

Jenkins and Thomas (Econews) conducted interviews with 81 UK, Swiss and German firms to find out why these firms invest in the SADC region. Their findings were as follows:

- 84 % - Size of the local market
- 40 % - Local raw materials
- 26 % - Personal reasons
- 21 % - Strategic reasons
- 19 % - Privatization

The most common reason given as to why Africa does not attract much FDI, is the image that Africa is unfavourable location. Africa is painted as a continent of civil unrest, starvation, deadly diseases, and economic disorder. According to UNCTAD, the bad publicity the African continent gets has played a big role in discouraging foreign investors from investing (UNCTAD, 1999). This line of argument contradicts some literature on the concentration of foreign investment in Africa. Angola has received bad publicity in terms of the war in that country, but this did not deter foreign investors from investing there. Though the grisly aspects of African states receive attention, the positive developments in Africa are seldom reported and not widely known.

A number of reasons were mentioned that hindered FDI into African countries. These include market size, lack of policies, lack of profit opportunities, inconsistent setup, negative perceptions, shortage of skills, labour regulations, poor infrastructure and corruption (CUTS, 2002). Business indicated that extortion, bribery, and the lack of access to global markets are some of the factors that discourage investors from investing in Africa. Business also attributed the delay in getting approval to start a business as a reason for the drop of FDI to Africa. Emery et al (2000) gives the following reasons for the delay in getting approval to start a business in Africa:

- Customer service e.g. unhelpful attitude,
- Delays beyond the necessary for approval or signatures,
- Complexities caused by the need to administer poorly- designed incentive schemes,
- Lack of computerization or lack of capacity in registration or regulatory applications,
- Duplication of effort among agencies, which require the same information, and
- High costs caused by the requirements for company formation and up-front capital taxes.

# 4. ACTUAL INVESTMENT FLOWS

FDI flows to developing countries surged in the 1990s and became their leading source of external financing. In Africa, the main attractions for FDI are market-related, notably the size and the growth of the local market and access to regional markets. In China and India, the biggest attractions are the size of the domestic markets. In Latin America, investment has been attracted by profitable opportunities from privatization. Most new investment inflows go into non-tradable service and manufacturing industries producing mostly for the domestic market.

Investment flows to Africa have declined steadily. In the 1970s, Africa accounted for 25% of foreign direct investment to developing countries. In 1992 it only accounted for 5.2% whereas in 2000 it received 3.8% of the total FDI to the developing world. During the period of 1982-1999, most FDI flows to developing countries were directed towards the South, East and South-Eastern Asia followed by Latin America. The SADC region on the other hand experienced a decline from 0.9% to 0.3% between 1995 and 2000.

According to the WIR (2001) FDI inflows to Africa declined from $10.5 billion in 1999 to $9.1 billion in 2000. African share of FDI in the world fell below 1 percent in 2000. The inflow to its top recipients, namely, Angola; Morocco; and South Africa have fallen by half. The main sources of FDI to Africa were France, the United Kingdom, and the United States, and to a lesser extent, Germany and Japan (WIR, 1999).

On average FDI flows to North Africa remained more or less the same as in the previous year, $2.6 billion. Flows declined into Morocco and Algeria but increased to Sudan (concentrated in petroleum exploration) from $370 million to $392 million. Egypt has remained the most important recipient of FDI flows in North Africa.

In sub-Saharan Africa, there has been a decrease in FDI from $8 billion in 1999 to $6.5 billion by the year 2000. A sharp drop of inflows into two countries caused the overall drop of inflows into Sub-Saharan Africa: Angola and South Africa. In South Africa, the reduced inflow of M&As in the country played a role in the downturn. The decline of inflows in Angola resulted in FDI flows to the least developed countries to drop from $4.8 billion in 1999 to $3.9 billion in 2000.

More recently, a group of African countries including Botswana, Equatorial Guinea, Ghana, Mozambique, Namibia, Tunisia and Uganda have attracted rapidly increasing FDI inflows. The reasons I differ from country to country. In the case of Equatorial Guinea it was mostly rich reserves of oil and gas. Natural resource reserves also played a role in the case of Botswana, Ghana, Mozambique and Namibia. Privatization has been pointed out as a factor which is attributed to attracting FDI to countries like Mozambique, Ghana and Uganda.

Angola has attracted most FDI in Africa, compared to its GDP, particularly in offshore exploration of gas and petroleum. The Angolan case proves that it is insufficient to base an analysis of FDI trends only on what business determines as attractive for FDI. Angola attracted resource-seeking FDI despite being the site of a longstanding war. After Angola, South Africa is attracting most FDI in the Southern African region, mostly from the US and the UK. Even though South Africa is supposed to be one of the recipients of FDI, the figures given by UNCTAD do indicate that South Africa is also a massive exporter of capital. South Africa is seen as the most attractive country for FDI by business (SOMO and LaRRI, 2001).

## 4.1 Flows by region: SADC

The Southern African Development Community (SADC) was established in 1992 out of the South African Development Coordination Conference. SADC committed itself to develop protocol that should take into account the heterogeneity of the region and interests of the different stakeholders (International Investment Treaties in S.A). The SADC trade protocol was signed in 1996 by all member states and it provides for the creation of a free trade zone among the member states. The main aim of the protocol is to contribute towards the improvement of the climate for domestic, cross-border and foreign investment.

Due to the drop of FDI flows into Angola and South Africa, the overall SADC region experienced a fall in flows from $5.3 billion in 1999 to $3.9 billion in 2000. However, countries like Mauritius and Lesotho experience strong increases in FDI whereas others, for example, Zimbabwe experienced a significant drop from $444 million in 1998 to $59 million in 1999 and only $30 million in 2000 (WIR, 2001).

The latest figures of FDI into SADC by UNCTAD (2001) reveal that the highest amount of FDI inflow in absolute terms was recorded by Angola (US$ 1,8 billion), followed by South Africa with an inflow of US$ 877 million. The rest of the region accounted for FDI inflows of less than US$300 million in the year 2000.

## 4.2 Flows by sectors

A large proportion of FDI is directed towards the primary sector, especially oil and gas. Between 1996 and 1999, most investments in the SADC region went into the metal industry and the mining sector and thereafter into the food, beverages and tobacco sectors. Other sectors like tourism accounted for a small amount of FDI. Sectors attracting FDI in the SADC region in order of priority are: the mining and quarrying; financial services; food; beverages and tobacco; agriculture, forestry and fishing; hotel; leisure and gaming; other manufacturing; energy and oil; telecom and IT; retail and wholesale; and; construction (Hansohm et al, 2002).

# 5. THE COSTS AND BENEFITS OF FDI

Foreign Direct Investment as a development tool has its benefits and risks, and will only lead to economic growth in the host country under certain conditions. It is the responsibility of governments to make sure that certain conditions are in place so that FDI can contribute to development goals rather than just generating profits for the foreign investor. These conditions cover broad features of the political and macroeconomic environment. The impact of FDI in a country would depend on a number of factors such as:

- The mode of entry (greenfield or merger and acquisition),
- The activities undertaken, and whether these are already undertaken in the host country,
- Sources of finance for FDI (reinvested earnings, intra-company loans or the equity capital from parent companies), and
- The impact on the activities of domestic companies (CUTS, 2001).

The potential problems associated with FDI include:

- Impact on domestic competition. FDI and in particular M&As are likely to have a negative impact on the level of competition in the domestic market. This may lead to restrictive business practices and abuse of dominance. TNCs may damage host economies by suppressing domestic entrepreneurship and using their superior knowledge, worldwide contacts, advertising skills, and a range of essential support services to drive out local competitors and hinder the emergence of small scale local enterprises.
- Impact on the balance of payments. The trade deficit can be a real constraint for developing countries. If investors import more that they export, FDI can end up worsening the trade situation of the country.
- Instability. Volatility is associated more with portfolio capital flows. Although investment in physical assets is fixed, profits from investment are as mobile as portfolio flows and can be reinvested outside the country at short notice. Profits may surpass the initial investment value and FDI may thus contribute to capital export.
- Transfer pricing. This refers to the pricing of intra-firm transactions which does not reflect the true value of products entering and leaving the country. This could lead to a drain of national resources. Countries may lose out on tax revenue from corporations, as they are able to juggle their accounts in such a manner as to avoid their tax liabilities.
- The impact of development, when FDI occur through TNCs is uneven. In many situations TNC activities reinforce dualistic economic structures and acerbate income inequalities. They tend to promote the interests of a small number of local factory managers and relatively well paid modern-sector workers against the interests of the rest of the population by widening wage differentials. They tend to worsen the imbalance between rural and urban economic opportunities by

locating primarily in urban export enclaves and contributing to the flow of rural-urban migration.
- TNCs use their economic power to influence government policies in directions that usually do not favor development. They are able to extract sizable economic and political concessions from competing governments in the form of excessive protection, tax rebates, investment allowances and the cheap provisions of factory sites and services. As a result, the profits of TNCs may exceed social benefits.

# 6. RECOMMENDATIONS AND CONCLUSION

Based on the experiences with FDI in Africa, a SADC seminar that brought together researchers, trade unionists and NGOs in Windhoek, Namibia in February 2001, recommended the following:
- Africa should abandon its open door policy to FDI,
- Africa should determine the national policy and set the context for FDI. Social policy and the public sector cannot be handed over to international institutions or the private sector,
- Africa should resist all additional conditions that come with FDI and instead African governments should set up their own conditions with regard to FDI,
- Africa should retain savings as the basis for domestic capital accumulation. Other areas that need to be addressed in order to maintain own financial resources are:
  - transfer prizing (changing prizes charged by companies when moving their products between their units in different countries in order to avoid high taxes)
  - payments for consultations
  - fees for copy writes and patents
  - looses due to privatization
  - looses due to structural adjustment programmes
  - loss through increased costs of interest payment
  - loss through continuing debt payments, especially for debts that were created by the apartheid regime.
- Africa should obtain technology that is not tied to FDI,
- Trade Unions and NGOs should put pressure on Southern African governments to join forces in order not to succumb to pressure from the North during negotiations in the WTO,
- There is a need to stop the liberalisation of capital movements and speculative capital flows at global level,
- Africa should develop regionalism as defined by the people, and not by the EU or the US, and
- Africa should use the concept of selective de-linking from the global economy within regional settings but not as a form of national autarchy.

Due to many socio-economic problems facing African countries, most have become desperate in trying to find solutions. The problems vary from high unemployment rates, poverty, and lack of technology. In their efforts to overcome these problems, most African countries have taken advice from bodies such as the IMF and the World Bank to liberalize their economies in order to attract FDI which in turn, they believe, will bring development.

The liberalization of economies have led to African countries engaging in privatisation, introducing incentives to attract FDI in the form of tax holidays, relaxing regulatory framework, and introducing investment promotion agencies responsible for

attracting FDI. Since most of the African countries have liberalized their economies, it would be expected that FDI flow, to African countries, would have risen, but to the contrary, actual flows of FDI to Africa have been on the decline.

The privatization process, which has been preached by the IMF and the World Bank as one of the prerequisites for attracting FDI to developing countries was not successful and often resulted in further hardships for the poor as was the case in Zambia and many other African countries.

One of the main outcomes of using incentives to attract FDI is the increase competition among African countries. This has lead to countries engaging in a 'race to the bottom', offering investors more and more attractive financial incentives, and reducing the regulatory requirements on firms. Engaging in this type of competition almost inevitably means that even the country that 'wins' (the investment) has paid too high a prize for it. Competition on investment incentives raises the distinct possibility that every country - big or small – could be worse off than if it were to refrain from using FDI incentives altogether.

CUTS pointed out that incentives are only useful to the extent that they succeed in attracting investment to one country from another and that they do not create new flows of FDI (CUTS, 2001). It has been proven that incentives do not work in attracting firms as foreign firms come due to factors such as the size of the market, privatization, resource extraction and personal reasons. Some African countries go to the extent of making changes to their regulations and restrictions on mobility of capital, whereas some countries such as Zambia introduced structural adjustment policies to try and attract FDI.

The fact that most countries have created a conducive environment to attract FDI, but that FDI flows to Africa are still on decline has shown the contradiction to the claim that the 'conducive environment' is critical for FDI. Thus it can be concluded that it is not conducive environments or incentives that attracts FDI, but that FDI decides on where to invest based on other reasons. As Tandon has pointed out, nothing seems enough to attract FDIs into ones economy, more and more incentives are needed to seduce FDIs. For example, workers are expected to abstain from strikes and not even bargain for better salaries. Fear of sending the wrong signal to the investors has lead to workers rights being compromised.

Tandon indicates that there is no real evidence that FDIs brings development, just as there is no evidence that liberalization, in general brings development (Tandon, 2002). It is important to keep in mind that FDI is not in business for development, but to make profit, whereas governments are supposed to ensure development. The fact that the goals of both government and investors are not the same, does indicate that it becomes a very difficult task to direct FDI in a way that will lead to development.

Thus the theory that FDI brings development and growth needs to be reviewed in order to prove whether or not it holds water. Tandon could be right when he stated that it is growth that attracts FDI and not FDI that brings growth. The main challenge is for the IMF, World Bank and others that argue that FDI is important for growth and development to present information in the form of case studies that supports their argument.

African countries should exercise caution when they open their doors to FDI. In the process of attracting FDI, government should assess what kind of development the country needs, target FDI accordingly, and then set up policies which will guide the developmental process of the country. FDI must only be allowed to operate under

certain nationally determined conditions and must conform to certain performance requirements that will ensure a positive impact on development.

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