Foreign Direct Investment and Africa's Economy, Opportunities and Challenges

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Theme: Africa's Productivity in the 21st Century, Who owns Africa?

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Abstract

Most developing countries in Africa, Asia and Latin America adopted neo liberal free market economic policies in 19980 (Evans and Sewell, 2013). The move had its roots from external influence under World Bank and IMF Structural Adjustment Programs (SAPs). Neo liberal economic policies are economic approaches that are based in free market economy, privatization of publically owned enterprises, de-regulation of markets and minimal involvement of state in economy. It is under this context African countries opened market for Foreign Direct Investment. However, despite national and regional strategies, it appears that African countries have become losers under FDI particularly for the manufacturing sector whereby its manufacturing industry has remained stagnant with high importation than exportation. FDI have extended the formal colonial relations between developed and developing countries whereby Africans produce what they do not consume and consume what they do not produce. This paper presents an analysis of FDI opportunities and challenges in Africa's economy with particular focus on the manufacturing sector, covers success stories from East Asia. Generally, the paper respondents to the theme of the 12th Africa Resource Bank Forum which is "African productivity, who owns Africa?" .Lastly the paper recommends African states to put in place effective legal and policy frameworks to ensure that FDI in Africa results into structural transformation of the economy from resource based and low value add activities towards sustainable growth with well advanced manufacturing sector.

Introduction

In the last three decades of the twentieth century, the world's political economic framework underwent a transformative move from a state-led to a neoliberal form (Sewell 2005). Specifically, after the In the World War II, economies in all areas of the world had been governed by state-centered regulatory regimes. However, in the wealthy countries of North America, Western Europe, Japan, and the Antipodes, economies were based on free markets and private property, but they were carefully steered and regulated by democratic Keynesian welfare states contrary to the communist countries wherein almost all economic activity took place in authoritarian state institutions. To the large extent, countries of Africa, Asia, and Latin America governments imposed ambitious schemes of state-led economic policies.

Due to economic crisis experienced by state led economic countries in the course of 1970s, government abandoned their socialist approaches by privatizing publicly owned enterprises, lifting capital controls, deregulating markets, and, more selectively, paring back welfare guarantees in 1990s. at this point, majority of developing countries in Asia, Africa, and Latin America had abandoned important elements of their nationalist development strategies and opened their borders to global flows of capital and goods some on their own will and others under the coercive mechanisms of the International Monetary Fund (IMF) and the World Bank such as the Structural Adjustment Program (SAP) (Diyamett et al., 2011). It is when the Foreign Direct Investment (FDI) took momentum as a way to enhance economic growth and technology transfer across the world.

Rutherford (1998:178) clearly defines of FDI as a business investment in a country other than the home country. FDIs are normally undertaken by Multinational Enterprises (MNEs) which must have a least 10% of equity shares. FDIs are motivated by three major factors namely, markets, resources and efficient environment for business. Additionally, it is perceived by investing in a foreign country, FDIs are able to build local technological capabilities through different channels and facilitate spillover effect linking investments with other sectors of the economy in host country.

Furthermore, literature distinguishes between vertical and horizontal FDIs. According to literature, horizontal FDIs, are the type of FDI undertaken for the purpose of placing production closer to foreign markets. Under horizontal FDI, production of goods and services in the host economy replace exports and FDI can substitute trade (Markusen, 1984) and Brainard (1993). On the other hand, vertical FDI, as defined by Helpman (1984), refer to the type of FDI that is undertaken to exploit lower production costs in order to serve both foreign and home market. This means, vertical FDI can be a complementary to trade when a part of the production in the host economy is exported back to the home country.

Considering overemphasis of Foreign Direct Investments (FDIs) as important aspects of economic development and transformation of host countries, this paper critically analyses the contribution of FDI in manufacturing sector for African economies. The overall purpose is to arrive to the conclusion which provides new approach that will make FDI contribute adequately in advancing the manufacturing sector in Africa. This paper is based on secondary data analysis from different countries in Africa.

Opportunities for Africa’s Economy through FDI

The United Nations Millennium Declaration of September 2000 indicates that an increase in FDI will help Africa achieve its Millennium Development Goal (MDG) of reducing poverty rates by half in 2015. Similarly, the importance of FDI in eradicating poverty is also highlighted in the New Partnership for Africa’s Development (NEPAD) declaration of 2003, which demonstrates that in order for the continent to achieve the MDG, the region needs to fill an annual resource gap of US$64 billion which is about 12 per cent of GDP. Furthermore, emphasis is put on foreign capital based on the argument that income levels and domestic savings in the region are low (Asiedu, 2006).

The Economic Report on Africa by the United Nations Economic Commission for Africa of 2011 advocates that FDI is the key to solving Africa’s economic problems. Bodies such as the IMF and the World Bank since 1980s have been suggesting that attracting large inflows of FDI by creating favorable incentives would result in economic development. Sub–Saharan African governments are 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 resulted from the introduction of SAPs and the internalization of neo-liberal assumptions promoted by the World Bank and IMF.

As reported by the Standard Bank (2014), foreign direct investment into Africa has continued despite the ongoing global economic challenges. The report highlights that

FDI into Africa has increased dramatically in the last and half decade with regard to the record that in 2000, not a single African country attracted more than USD2bn year-on-year in FDI inflows, while by the end of 2012 no less than eight countries on the continent had attracted more than USD2bn in FDI, year-on-year. Furthermore, Africa continues to be a preferable destination on the global FDI landscape even though investment into manufacturing sector continues to struggle. The FDI inflows to developed economies declined by 32% in 2012 to USD561bn, according to the World Investment Report. By contrast, FDI inflows to Africa rose for a second consecutive year in 2012, climbing by 5% to USD50bn making Africa one of the few regions worldwide to register year-on-year growth in 2012.

Africa is resource rich continent on the planet which attracts FDI inflows. The 2014 Africa Economic Outlook notes that, Africa's total FDI is also highly concentrated in resource-rich countries. Huge investment on the continent remains concentrated in the energy, mining, telecommunications, financial services and consumer sectors. However, the energy sector is attracting the bulk share of FDI at the moment. In 2013 a mere 12 energy transactions contributed about USD11.5bn in inward FDI to Africa which is higher compared to 11 mining and 10 financial services transactions, which together contributed just USD400m in FDI flows to the continent.

On top of the above, Rojid et al. (2009) analyzed potential determinants of FDI for a sample of 20 African countries for the period between 1990 to 2005. The scholars concluded abundance of natural resources, openness to trade, and the size of the domestic market and the stock of human capital are positive in attracting FDI. They further conclude that political instability and labour costs have a negative implication to FDI attraction. Africa's rapidly developing energy sector is likely to attract greater investment given the rapid expansion of the sector because in 2012, Africa had 21 countries with proven oil reserves while 24 nations on the continent had proven natural gas reserves. It is therefore estimated that estimated that Africa's oil production will increase from 9.4-million barrels per day (bpd) in 2011 to 12-million bpd by 2020 Standard Bank, 2014).

The Challenge of Structural Transformation

Despite the rapidly increasing FDI inflows in Africa, structural transformation remains to be the most notable challenge in the African economy. Structural transformation in the African context means transformation of the system of "production" from the existing one that is dominated by primary extraction and low value-added agriculture and services, to one in which high value is added through the application of technology, and innovation with better linkages between economic sectors to the large extent. The African economy needs structural transformation reducing the share of relatively dominant sectors of today (agriculture and raw minerals/fossil fuels) in the economy to the manufacturing and value added services. Africa is yet to have a successful economic transformation with mixed (small, medium and large enterprises) and balanced economy. An economy that will put money, wealth and capability in many hands, enable governments to finance social welfare through taxation (Abugre, C and Ndomo, A, 2014).

FDI inflows in Africa are unevenly distributed geographically and sector-wise. FDI inflows into Africa remain concentrated among a relatively small number of countries, the continent's top six FDI beneficiaries in 2013 were South Africa (USD6.4bn), Nigeria (USD6.3bn), Mozambique (USD4.7bn), Morocco (USD4.3bn), Ghana (USD3.3bn), Sudan (USD2.9bn). Moreover, the continent's top six FDI recipients in 2013 only accounts for a third of the continent's population and received the same amount of FDI inflows as the remaining 48 countries combined. Furthermore, it is estimated that investments in Africa's energy sector is likely to attract approximately USD1.5tr by 2030 and will also continue to attract FDI in mineral resources such as gold, copper, Silva and uranium (AfDB, OEDC, UNDP, 2014).

Evidence suggest that Africa's economy have not transformed from a low value add and resource exaction based into industrialized with modern service sector. According to literature, agricultural commodities, timber, metals and minerals, and hydrocarbons, as well as natural resources have accounted for roughly 35% of Africa's growth since 2000 to 2011. Resource-based raw and semi-processed goods accounted for about 80% of African export products in 2011 which is higher compared to other regions such as 60% in Brazil, 40% in India and 14% in China. In similar regard, most greenfield FDI in Africa went to natural resources based activities (AfDB, 2013). This suggest the mismatch between DGP growth and social economic development in the continent characterized with poor industrialization, high unemployment rate particularly for youth, poor income levels of individual citizens and inability of government to finance social services (education, health, water and improved settlement) due to limited tax based (Abugre, C and Ndomo, A, 2014).

Studies inform that FDIs in Africa do not have the spillover effect of promoting growth and boosting the manufacturing sector through technology transfer to the host countries (Asiedu, 2006: Diyamett, 2011). This is because of the weak legal and policy frameworks to facilitate the spillover effects to host countries for developing countries. Although the relationship between FDI and growth is unclear (Durham, 2000)., some studies have found a positive relationship between FDI and growth (De Gregorio, 1992; Oliva and Rivera-Batiz, 2002) while other studies conclude that FDI can contribute to growth only under certain conditions which include; when host country's education exceeds a certain threshold (Borensztein et al., 1998); when domestic and foreign capital are complements (de Mello, 1999); when the country has achieved a certain level of income (Blomstrom et al., 1994); when the country is open (Balasubramanyam et al., 1996) and when the host country has a well-developed financial sector (Alfaro et al., 2004). In contrast, Carkovic and Levine (2002) conclude that the relationship between FDI and growth is not robust. This means that Africa countries are supposed to undertake of a critical analysis of their economic situations and prepare strategies not only to attract FDIs but more on how to leap from them.

Report by the United Nations International Trade conference (2005) warns that FDI carries costs as well as benefits for the host country. It advices that policy makers must fully evaluate the impact of FDI if it is to become a most determining factor for development. Furthermore, strategic interventions are needed for sustainable economic growth and development, create jobs and diversify activities of FDI in Africa, strategies to ensure linkages between FDI in natural resources and development in the manufacturing sector are needed to address overdependence on commodity exports by African countries as well as a deindustrialization trend following the debt crisis of the early 1980s (UN, 2005).

At this point, it is important to bring in the analysis success stories from other regions in managing FDIs for socio-economic development. In the following section, the paper demonstrates brings in the picture cases of Asia and Latin America on FDI and Economic transformation.

Why Worked in other Regions?

There is agreement among scholars that Africa's sustainable development relies upon breaking of the vicious circle of commodity dependence to independent and productive manufacturing sector. Manufacturing sector does not only guarantee sustainable economic development but will also foster integration with other economic sectors such as rural and urban economies, agriculture and processing activities, consumer and intermediaries (Wade, 2003). Under the liberal economic frameworks, the west has managed to pioneer what Shivji (2009) calls as disarticulation of African economies. FDI and other interventions have continuously widen the gap between what is produced and what is consumed in Africa, there is disarticulation between agriculture and manufacturing whereby agriculture is existing independently of the industrial sector due to incased importation of readymade good and exportation of agriculture and natural resources in raw form (Shivji, 2009). Africa as a whole needs to intervene the FDI systems by imposing a condition against profit transformer to western countries. For instance, FDI on mineral resources such as Gold mine should be allowed to export Gold products and not minerals in raw form. If FDI is investing in cotton farming then the final products (including cloths) are the goods that should be exported and the same applies to other entities.

The above point is the pattern that countries in East Asia undertook even though for them it was more on the incentive package. Economic Processing Zones (EPZs) in East Asia promoted FDIs with manufacturing capacity is order to break the commodity dependency vicious circle. It should be noted that Africa stood at the lower level of industrialization similar to where East Asian countries stood during manufacturing sector revolution (UNCTAD, 1997). However some of the African countries have tried to adopt some of the Asian interventions such as establishing the EPZs but unfortunately the results have not been impressive. This is because of the difference in governance systems between EPZs in Africa and those in East Asia. A study in Tanzania found out that FDIs under EPZs are enjoying tax holidays while not producing anything new, most are doing repairs of imported goods, companies are found importing expertise and processing raw materials from their home countries hence no value addition or boosting of the manufacturing sector is taking place (Thomas, 2013).

While FDI has been reported not to be the catalyst for technology transfer and skills capacity building in Africa (Diyamett et al., 2011), the opposite has been reported for East Asian Countries (UN, 2005). Various policies to deal with FDIs in East Asian countries have been developed linked to the countries' broad development strategy particularly for improving exportations. In the most Asian tigers FDI incentives reverse importation of goods; they include technology capacity assessment for FDI firms, domestic content inclusion, and prohibit entry into infant sectors (Chang and Green, 2003). Probably one of the mistakes that Africa has been making is being too flexible in terms of development agenda which could be associated with external interferences. Some of the countries do not even have blue print for priority sectors when it comes to FDI. Some countries do have priority sectors without strategies to direct FDI to such sectors or without being sensitive so that FDIs in other sectors have a positive impact to the priority sectors. It should be observed that successful FDI is not a result of getting polices right but a mix of coordination measures including prohibited entry to other sectors, direct public investment and other interventions imposed to investment that can direct investments to productive sectors (UN, 2005).

Akyuz (2004) warns that African countries have to think locally and regionally in terms of market size, interlinkages between sectors of economy, interlinkage between the economy of one country and its neighboring countries before opening up for external markets. (UNCTAD, 2002) reports on the stagnation in manufacturing and value added activities in African countries (Ethiopia, Kenya and Cameroon) alongside weak exportation expansions which was a sign of pre-mature deindustrialization in 1990 under the adjustment programs was facilitated with rapid opening to external markets.

African Productivity, who owns Africa?

Considering the context of FDI in Africa, the paper is addressed the above question by look at Africa's major investors in Africa and the share of African products in the local market. As per 2013 Africa Economic Outlook the four largest investors from the Organization for Economic Cooperation and Development (OECD) countries in 2012 were the United Kingdom (USD 7.4 billion), the United States (USD 3.7 billion), Italy (USD 3.6 billion) and France (USD 2.0 billion). Furthermore, United States, the United Kingdom and France taken together, accounted for 64% of total FDI stock in Africa in 2012. Added further, emerging economies are becoming increasingly important investment sources for African countries. The share of the Brazil, India and China (BRICS) in Africa's total FDI stock rose from 8% in 2009 to 12% in 2012. The figure confirms the decreasing relative importance of OECD countries as sources of direct investment (OECD, 2014a).

Morrissey (2012) emphasizes that FDI has limited impact in Africa in African economy due to lack of linkages and spillovers to the domestic economy. The limited impact results from a number of factors including limited technological 'absorptive capacity' of domestic firms and concentration of FDI inflows in the resource sector rather than in manufacturing or services. Similarly, Amendolagine, Boly, Coniglio, Prota and Seric (2012) found out that the impact of FDI in Africa economy continues to be limited due to over concentration on resources based and particularly oil and gas which have fewer forward and backward linkages with other sectors of the economy unless specific policy mechanisms are put in place.

Up to the year 2010, the main exported commodities of African nations were, palm oil, gold and diamonds, oil, cocoa and timber (low value add products). On the other hand, value add manufactured goods were highly imported in Africa, those includes but not limited to, machinery and equipment, chemicals, petroleum products, wearing materials and foodstuffs. It is also not surprising to note that Africa trade has been dominated by foreign industrialized countries such as Germany, Japan and China (Economy Watch, 2010). This means that FDI has so far not helped African economy but deepens African dependency economically.

Conclusions and Way Forward

Governments in African countries need to first set priorities to determine the direction of FDI in their countries. They should lead the strategies such as prohibiting FDIs to extract raw materials from Africa and move away with the, investment agreements between multination corporations and host countries should be structured in such a way that each investment contributes in boost manufacturing and agricultural sectors because they are major economic sectors without which economic development can hardly be attained in Africa. Government regimes in Africa should be the one to prepare and put in place proper and enforceable agreements for FDI in a way that those agreements adequately addresses the needs to build a strong economic base meeting the needs of the local market of the host country as well as the needs of the external markets.

Since it is now familiar among development partners that Africa has continued to serve the imperial colonial mission of being the source of cheap labor, market, areas for investment and source of raw materials through FDIs, it is about time that Africa as a region stands against these unequal economic relations. This means Africa as an investment destiny for FDI, the region should come up with interventions that would limit profit procreation by FDIs in order to facilitated structural transformation of the economy from raw and less value add form of production to more industrialized Africa with modern service sector. . There is a need to put to an end exportation of materials in raw form from Africa particularly for FDIs investing in mineral resources. Policies should ensure that processing and final manufacturing processes of mineral products are done locally within the host country. As a resulting, FDI will have spillover across different sectors of the economy in the continent.

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