

Policy, Research, and External Affairs

WORKING PAPERS

Debt and International Finance

International Economics Department
The World Bank
March 1991
WPS 619

Foreign Direct Investment in Sub-Saharan Africa

Laurence Cockcroft
and
Roger C. Riddell

Foreign investment is even less likely to meet Sub-Saharan Africa's rising foreign exchange and savings gaps in the 1990s than in the dismal 1980s. Investors interested in Sub-Saharan Africa are more likely to commit technology and management than equity capital. Economic activity and overall economic policy may be more effective at raising the total volume of investment than special fiscal and other incentives.

WORKING PAPERS

Debt and International Finance

WPS 619

This paper — a product of the Debt and International Finance Division, International Economics Department — is part of a larger effort in PRE to assess the external financial situation of developing countries, overall and by regional and analytical group. Copies are available free from the World Bank, 1818 H Street NW, Washington DC 20433. Please contact Sheila King-Watson, room S8-040, extension 33730 (71 pages).

Cockcroft and Riddell examine trends in private foreign direct investment in Sub-Saharan Africa, assess how this has affected the host economies, and discuss the prospects for increased investment in the 1990s. They examine new or nontraditional forms of investment as well as more traditional stock and flow trends. They also focus on the relationship between structural adjustment programs and foreign private investment.

Clearly, structural adjustment programs have had a negative effect on high-cost, overprotected import-substituting industries in Sub-Saharan Africa; some were intended to do so. Structural adjustment programs are expected to attract a good deal of foreign direct investment but there is little evidence yet that they are doing so.

Foreign investment in the 1990s (as in the 1980s) is likely to flow to a few key sectors: energy (certainly minerals), selected export manufacturing sectors, and possibly the tourist industry. The least attractive area for the foreign investor is exclusively import-substituting industrialization.

Investors interested in Sub-Saharan Africa are more likely to commit technology and management than equity capital. As a result, development finance institutions are likely to play an increasingly important role in meeting the need for capital.

Thus, activity in Sub-Saharan Africa may be more effective at raising the total volume of investment than any change in the climate of fiscal and other incentives.

There is no prospect whatsoever for foreign investment to meet Sub-Saharan Africa's rising foreign exchange and savings gaps — indeed, the prospects may be worse in the 1990s than in the dismal 1980s. For one thing, prospects in other parts of the rapidly changing world look brighter and less risky and are closer to home. For another (Catch 22), Sub-Saharan Africa is unlikely to attract capital until the prospects for growth improve — which is more likely in countries that succeed in attracting more public and private foreign capital.

The PRE Working Paper Series disseminates the findings of work under way in the Bank's Policy, Research, and External Affairs Complex. An objective of the series is to get these findings out quickly, even if presentations are less than fully polished. The findings, interpretations, and conclusions in these papers do not necessarily represent official Bank policy.

Foreign Direct Investment in Sub-Saharan Africa

by
Laurence Cockcroft
and
Roger C. Riddell

Table of Contents

I.	Introduction	3
II.	Overview of Foreign Direct Investment in Sub-Saharan Africa in the 1980s	4
II.1.	Aggregate Trends	4
II.2.	New Forms of Investment and Equity Sales	15
II.3.	Structural Adjustment and Foreign Direct Investment	17
II.3.1	Costs and Benefits of FDI	17
II.3.2	Disappointment in the Short Term	20
II.3.3	Improvements to the "Enabling Environment"	27
III.	Particular Successes and Problems in the 1980s	33
III.1.	Individual Examples Against the Aggregate Trends	33
III.2.	The Nigerian Textile Industry: A Case of Import Substitution	38
III.3.	Export Processing Zones	40
IV.	Foreign Investment in Sub-Saharan Africa in the 1990s	43
IV.1.	Overview	43
IV.2.	Change in South Africa	47
IV.3.	Improving the Investment Climate by Addressing Specific Constraints	49
IV.3.1	The Media	54
IV.3.2	Skill Shortages	55
IV.3.3	Inadequacies of the Domestic Infrastructure	56
IV.3.4	Bureaucratic Delays and Lack of Decisions	57
IV.3.5	Country Size and Regional Markets	58
IV.3.6	Providing Matching Finance	59
IV.4.	A More Active Approach to Investment Promotion	62
V.	Conclusions	66
	Bibliography	68

I. INTRODUCTION

There is a series of benefits which, taken together, make foreign investment particularly attractive to African countries as they begin the 1990s. Two of the principal factors inhibiting higher levels of economic growth in SSA in the 1990s are low levels of investment and foreign exchange shortages. The first attraction of foreign investment lies in its potential to address both these constraints. On the one hand, inflows of foreign investment bring in foreign exchange, supplement domestic savings and raise the level of investment. On the other, import substituting investment can help to reduce the import bill, while investment in export industries will directly increase a country's foreign exchange earnings.

There are, additionally, a number of secondround benefits which might also be anticipated to arise from increased foreign investment. These include: the creation (or expansion) of local industries to supply inputs to the newly-established plant; a rise in the overall level of domestic demand, boosting incomes and, through taxation, state revenues; and the transference of labour (including management) skills and technology.

A third benefit would be the enhancing of the efficiency of the domestic economy, an effect likely to start occurring prior to the anticipated investment flows. Significant inflows of new external private investment are only likely to come to a country which provides a climate that is conducive to profit and in which it is relatively easy to conduct business. To create such a climate entails addressing a range of domestic problems which have characterised African economies increasingly over the past two decades, such as the over-extended state, bureaucratic inefficiencies, a wide range of administered controls, financial and other infrastructural constraints.¹ Seriously addressing - if not resolving - these problems is almost certainly a pre-condition for new foreign investment, but it has the added benefit of improving and enhancing the efficiency of the domestic economy. In practice the two issues tend to be interlinked, as creating a climate more conducive to raising domestic investment levels undoubtedly enhances the climate for foreign investment.

¹ The list of constraints is discussed and analysed in World Bank (1989b).

The broad objectives of this paper are to examine the prospects for foreign investment in SSA in the 1990s in the context of what has happened in the most recent past, focusing on levels and types of investment, and on changes in policies which have affected, or could affect, the level and the type of foreign investment. The discussion clearly shows that the potential benefits of foreign investment are not being reaped at present: outside particular primary sectors of the economy, especially in mining and certain agricultural ventures, there remains a substantial gap between potential benefits and anticipated foreign capital inflow. Even in these sectors, levels of new investments have fallen during the 1980s. What is more, new foreign investment inflows do not (yet) appear to have materialised in countries which have embarked on substantial structural adjustment programmes. The paper ends by attempting to isolate the main constraints which appear to be impeding new foreign investment inflows and advancing some ideas for ameliorating them.

II. OVERVIEW OF FOREIGN DIRECT INVESTMENT IN SUB-SAHARAN AFRICA IN THE 1980s

II.1 Aggregate Trends

A number of difficulties arise in attempting to examine trends in foreign direct investment (FDI) in sub-Saharan Africa (SSA). Foremost are inadequate national statistics or the absence of data (particularly in regard to recent stock data), accentuated by under-reporting, especially of outflows. These problems are reflected in part in the different estimates published by the different international agencies, as well as in the dominance, and therefore influence, of the atypical Nigeria,² which accounted for 40% of all net inflows during the 1981-86 periods and where data are particularly suspect. Trends in aggregate flows across countries are additionally difficult to assess for Africa in the 1980s because of major shifts in exchange rates, which occurred at different times for different countries.

² Nigeria is atypical because of both its size and the dominance of oil investments. Net foreign investment to Nigeria averaged over \$500 mn a year from the mid-1970s to mid-1980, twice the amounts recorded for Cameroon and Gabon combined.

Nonetheless, data published by the Organisation for Economic Co-operation and Development (OECD) and the United Nations (UN) appear to indicate some firm trends of foreign investment to SSA in relation to other regions of the developing world. Up to at least the mid-1970s, foreign investment appeared to have an aggregate influence in African economies similar to that in other areas of the developing world, the major difference being the dominance of investment in Africa in the primary sectors of agriculture and mining. During the course of the 1980s a marked change occurred, such that today, in comparison with other areas of the developing world, foreign investment in Africa plays a comparatively small role in both overall investment and as a share of total external resource flows.

SSA³ accounted for only 14% of the total developing country stock of foreign investment in 1985, falling from some 27% in the year 1975. Whereas in real terms the stock of total foreign investment in all developing countries increased over this period by 76%, the stock value in SSA fell by 8% in real terms. It increased in all other major sub-regions of the developing world. The trend in stock values by sub-region at current prices is shown in Table 1.

³ These are inward stocks of foreign direct investment and are for what is termed Developing Africa, which includes the countries of North Africa. The figures for SSA are likely to have been even more adverse. (United Nations, 1988:25).

Table 1
Inward Stocks of Foreign Direct Investment, 1975 and 1985
 (\$ bn Current)

Region	1975		1985	
	Value	%	Value	%
SSA	16.5	26.8	22.3	14.0
Asia	13.0	21.4	49.6	31.2
Latin America & Caribbean	29.7	48.2	80.5	50.6
Other	2.3	3.7	6.6	4.2
Totals	61.5	100	159.0	100

Source: UN, 1988:25.

In relation to the composition of the stock of foreign investment, in 1982, the share of foreign investment in all developing countries was distributed as follows: primary sector - 19%; secondary sector - 44%, and tertiary sector - 38%. In Asia, the ratios were respectively 12%, 49% and 39%, and for Latin America and the Caribbean, 21%, 58% and 22%. For SSA, however, 55% was located in the primary sector, with only 28% and 20%, respectively, in the secondary and tertiary sectors (Dunning and Cantwell, 1987).

As for flows of foreign investment, the recent changes would appear to have been even more marked. During the 1980s (at least up to 1987) aggregate trend figures indicate that there has been a fall in net investment flows to all developing countries, even in current price terms. But for most sub-regions, and in aggregate, the fall in total flows has been small. It has been less severe than the fall in aggregate net inflows, so that foreign investment flows have tended to form a rising share of total foreign resource inflow. For SSA, however, there has been a dramatic overall fall in both the net inflow of foreign investment and in the share of private investment to total foreign resource inflow, the latter

occurring - in the case of SSA - because of a rise in official development assistance. According to OECD data, whereas in the three year period 1980-82 direct private investment accounted for 9.9% of total net resource flows to SSA, the ratio of foreign investment to total external inflows had fallen to just 2.3% for the years 1985-87. In contrast, the ratio of direct foreign investment to total resource flow for all developing countries between the same periods rose from 10.8% to 14.4%. It fell only marginally from 5.3% to 4.2% for all low-income countries, stayed roughly the same for Asia and almost doubled for countries of the Western Hemisphere (OECD, 1989). The details are given in Table 2. Little appears to have changed in the intervening period to suggest that there has been any marked improvement either relatively or absolutely for SSA.⁴

Table 2
Direct Private Investment as Share of Total Net Resource Flows, 1980 to 1987
(\$ mn)

	Direct Investment		Total Net Resource Inflows	
	1980-82	1985-87	1980-82	1985-87
All developing countries	41.2	38.1	382.3	264.4
All low-income countries	5.8	5.8	7.0	137.3
Sub-Saharan Africa	5.0	1.3	50.4	56.2
Western Hemisphere	21.4	14.2	170.6	62.1
Asia	11.0	11.3	84.0	83.7

Source: OECD, 1989: Table III.

Analysis of OECD investment data suggests that the decade from 1978 to 1987 can be split up into three distinct periods: 1978 to 1983, 1983 to 1985, and post-

⁴ The International Monetary Fund's World Economic Outlook, for October 1989, suggests a minimal rise of overall net direct investment to all developing countries of 6% from 1987 to 1989, a figure itself lower (in current price terms) than that reached in all four years from 1981 to 1984, and some 70% less than the peak of \$19.8 bn reached in 1982.

1985. Trends in overall FDI in current prices, the flow of FDI going to SSA in fixed (1987) prices, and trends in the flow of FDI destined for all developing countries channelled specifically to SSA are reproduced respectively in Figures 1, 2 and 3. Figure 1 shows that the contraction (in current prices) in FDI which affected all developing countries in the early 1980s did not impinge upon the SSA sub-region until 1982 and did not last for as long -both categories recording an upturn *post*-1985. For all developing countries, OECD data indicate a rapid expansion in net inflows of FDI after 1985, with total flows exceeding (in current price terms) those reached in the early 1980s. For SSA, however, the upturn has been far less marked and by 1987, levels of private foreign investment inflow remained lower than they were at the start of the decade. This divergence is shown clearly in Figure 3. Figure 2 traces the annual trends in private foreign direct

Figure 1
Net Foreign Direct Investment Flows to Sub-Saharan Africa, 1979 to 1987, \$ bn

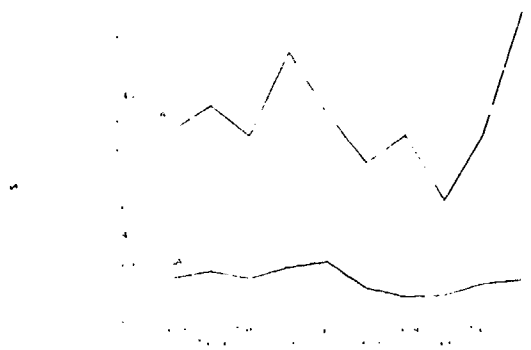


Figure 2
Net Foreign Direct Investment to Sub-Saharan Africa, 1978/79 to 1986/87 in 1987 Prices, \$ bn

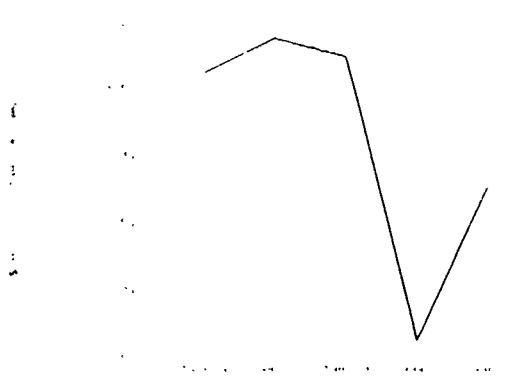
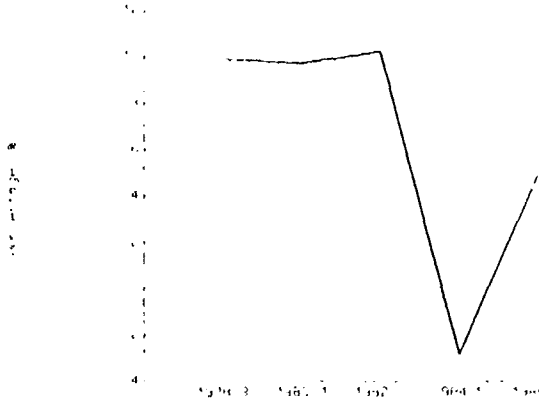


Figure 3

The Share of all Net FDI Flows to Developing Countries going to Sub-Saharan Africa, 1978 to 1987, Percentage



Source (for figures 1, 2 & 3):

OECD, 1989: Table III.

investment from 1978/79 to 1986/87 in real (1987) prices: by 1987, and in spite of a marked recovery (from a net outflow position in the mid-1980s), levels of FDI to SSA in 1987 (at fixed prices) were less than half those achieved at the start of the 1980s

Figure 4, comparing OECD and World Bank (World Tables) data, reveals both the very different estimates of net FDI to the SSA region and the very different annual changes in flows recorded by these two important sources. OECD data suggest far more volatility than do World Bank data, and only in three (out of a possible nine) years are the figures at all similar - in 1982 they differ fourfold. Additionally, in most years since 1980, when one source shows a rise in flows the other shows a fall. Figure 5 records trends in net FDI from World Bank sources, but excluding Nigeria. It suggests a smoother trend but, consistent with OECD data, indicates a downward trend of net inflows throughout the 1980s and a far from stable post-1985 recovery

Figure 4
Net FDI to Sub-Saharan Africa, 1974 to 1987, Comparison of World Bank and OECD data

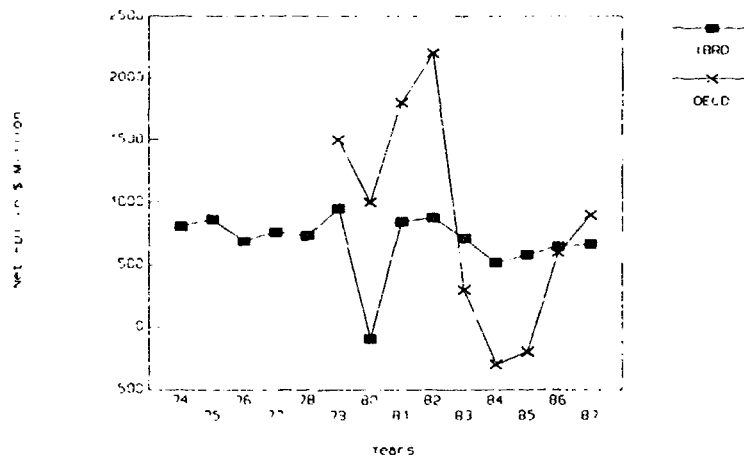


Figure 5

Net FDI to Sub-Saharan Africa, 1974 to 1987, World Bank Data with and without Nigeria

Source (for
Figures 4 & 5):

OECD (1989) and
World Bank World
Tables 1987

(tapes). Table 3

shows the

cumulative

direct

investment flow

of private

investment by

major OECD country from 1976 to 1986, and indicates the dominance of four countries, the USA, UK, Japan and France, which together accounted for over 80% of total investment inflow.

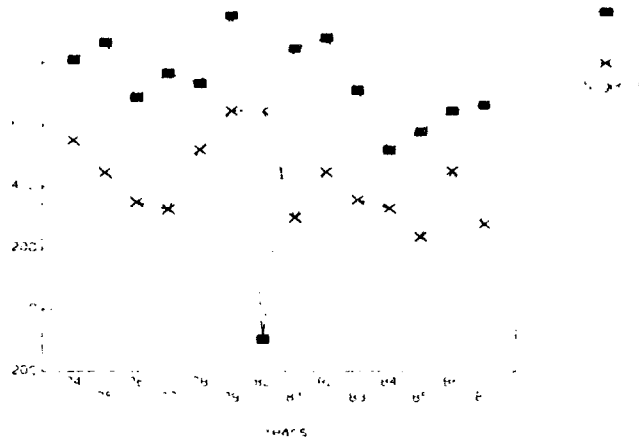


Table 3
Cumulative Investment Flows by Country of Investor, 1976 to 1986
 (\$ mn)

Country source	Investment in \$ mn	Percent
USA	2,297.0	27.4
UK	1,919.7	22.9
Japan	1,745.2	20.8
France	1,012.1	12.1
Belgium	645.2	7.7
Germany	369.5	4.4
Italy	296.5	3.5
Netherlands	105.1	1.2
World Total	8,390.7	100.0

Source: OECD, derived from Githongo *et al.* (1988:75).

It should be noted that these aggregate flows include the re-investment of unremitted profits, and re-invested funds constitute well over half of the total private investment inflow. In Nigeria, for instance, unremitted profits accounted for nearly all "new" FDI from 1970-74 (in the run-up to the first indigenisation decree), and for 83% from 1982-4. In Kenya in 1976, they accounted for nearly all FDI, and in 1986 still accounted for 45% of total foreign investment (Githongo *et al.* 1988: 119). What is more, unremitted profits have frequently been "unremittable" except in the nebulous long term. In the case of Zambia, for example, the authorities halted all dividend outflows for as much as three to four years: the option of re-investing profits has frequently simply been a "least bad" solution to the problem of idle dividends. Thus the commitment of offshore corporate investors to SSA in the 1980s has been even lower than the aggregate data would suggest.

The two countries which historically have dominated private investment in SSA are France and the United Kingdom. A recent analysis on trends of British private investment in the industrial sector in Africa (Bennell, 1990) points to a major withdrawal of British investment from this sector of African economies in recent years. Bennell's data suggest that whereas some 4% of net British private foreign industrial investment was in Africa in the mid-1980s, the share had dropped markedly to just 0.5% by 1986, falling in absolute terms from an annual average of £70 mn in 1978-80 to just £28 mn in the period 1985-6.⁵ Bennell's survey of British firms confirms that nearly one third of companies which had investments in the industrial sector in SSA in the late 1970s had disposed of them by mid-1989, the process of disengagement having taken place right across the continent.

Although probably on a smaller scale than the British figures, aggregate trends of French investments in Africa indicate minimal inflows of new money (except in oil), most investment originating from retained earnings - even if there has been less of a departure of French than British companies from Africa. Substantial disinvestment has occurred in both Burkino Faso and the Congo, while net foreign investment in two of the largest French-speaking economies of SSA, Côte d'Ivoire and Senegal, has fallen sharply. For Côte d'Ivoire, net private investment fell from \$63.5 mn a year in the period 1970-75 to \$25 mn a year in the period to 1980-86, while in the more recent 1985-87 period there was a net private capital outflow of some \$2.5 bn (Chang and Cumby, 1990); for Senegal, annual average private inflow was halved from \$17.5 mn in 1970-75 to \$9.5 mn in the period 1980-86 (UN 1988:5).

Among the "new" international investors, Africa has always been an area of minimal interest, but it has become even more marginal in the 1980s. Thus, taking the entire period 1951 to 1989, Africa accounted for just 2.8% of all Japanese private foreign investment, a significant fall from the 4.1% ratio recorded in the period 1951 to 1979 and reflecting higher ratios in the late 1960s and 1970s. Thus in the years 1982 and 1983, Japanese private investment to Africa accounted for over 4.5% of total Japanese foreign investment; yet by 1987 the share had fallen sharply to only 0.8% of its worldwide private investment (JETRO, 1989).

⁵ Bennell's study covers 15 countries of SSA, accounting for over 90% of all British industrial investment in Africa.

Nonetheless, as shown in Table 3, Japan remained the third largest source of foreign investment from 1976 to 1986.

Recent trends in private US investment in SSA have also shown sharp contractions, although not as pronounced (at least in the first half of the 1980s) as flows of private investment from other major sources. In 1985, Africa was the destination of less than 1% of all US private foreign investment (US Department of Commerce, 1986).⁶ Thus Coughlin (1990:247) records significant disinvestment by US private companies from Kenya in the 1980s.⁷

II.2 New Forms of Investment and Equity Sales

Since the nationalisation "phase" predominant in the 1965-75 period, a common feature of private capital investors has been to seek an involvement in African business which earns income with only a minimum commitment of equity capital. Until the deep recession of the early 1980s, governments frequently co-operated with this approach - in fact it was often a necessary consequence of the nationalisation of a major enterprise if there was to be any continuity in its management. Such income could be generated from management agreements, patent and technology licensing agreements, production-sharing contracts, and international subcontracting. These have been christened "new forms of investment" (NFI) by the OECD Development Centre (Oman, 1984 and 1989). This categorisation is based on a perception of them as embodying "capital" (for instance in the form of accumulated R & D expenditure) which is then applied to the development of projects in which the equity is at least 50% locally-owned, and in which the reward paid to NFI is linked to the profitability of the enterprise to which it is applied. The importance of NFI in SSA is indicated by the fact that in Nigeria various forms of NFI-type income accounted for 40% of the total investment income paid overseas from 1976-86, a figure which is twice the OECD estimate for the developing world as a whole (Central Bank of Nigeria data cited in Githongo *et al.* 1988).

⁶ The fact that US Department of Commerce data suggest a continued expansion of investment flows to Africa in the early 1980s, when OECD data show a severe overall contraction, is probably yet another example of the unreliability of the data on investment flows to SSA.

⁷ These include Firestone, Bank of America, First National Bank of Chicago and the American Life Insurance Company.

One reason why NFI have grown in importance has been the perceived riskiness of the economic environment in most African countries. Another, quite distinct, reason reflects the trend for multinational companies in both the food and minerals sub-sectors to diversify and to become purchasers, processors and distributors, rather than merely the producers of a commodity. In this case, their interest in Africa as a product source is dependent both upon the cost levels prevailing in Africa compared to other parts of the world, and the minimum amount of capital which they need to commit. As a consequence of both these factors, NFI-type deals will remain of great interest to potential overseas partners, and today there is frequently an NFI component to most new investments.

Foreign investors in Africa have for long co-existed with local entrepreneurs, but have seldom actively assisted in their development through purchasing a certain minimum of inputs from them. Exceptions to this are, on the one hand, the building industry and, on the other, the system of contract growing, often linked to nucleus estates and always to processing plants, practised by a number of agribusiness companies, particularly in eastern Africa. These resemble the contract growing systems developed by multinational companies in central and south America over the last forty years: in Africa they have their roots in the Gezira Board of the Sudan (established in 1923), and the rice and cotton buying state-owned companies of the northern savanna belt of Francophone west Africa (such as SEMRY in Cameroon, and Office du Niger in Mali).

In 1990, the most impressive "portfolio" of such projects is certainly that of the UK Commonwealth Development Corporation (CDC) which has a financial stake (in the form of both equity and loan capital) in 15 such projects in SSA. These include the Smallholder Coffee Authority in Malawi, which provides services to 4,000 growers, the Kenya Tea Development Authority, which supports over 150,000 small farmers, and the Mumias Sugar Company in Kenya, which supports over 30,000 "outgrowers".

Mumias, however, is one of the few such projects to have been partly financed by equity capital supplied by an offshore private investor,⁸ as distinct from a development finance agency. Developed as a pilot project in 1964, it was expanded to a commercial scale in 1969, and its outgrowers now produce over two mn tons of

⁸ In this case Booker Tate of the UK, which provided about 4% of the original paid up share capital.

cane, and 200,000 tons of sugar per year. The area farmed by outgrowers varies from 0.25 ha to 10 ha; the company provides working capital to cover planting and growing costs, which are deducted from the price for sugar cane offered at the factory gate. Under an NFI-type arrangement, Booker Tate provides a technical assistance contract which is performance-related, but now involves no more than one or two personnel on a permanent basis. Two further examples of the "contract grower" approach are provided in Kenya by the Njoro Agricultural Company, which has over 2,000 growers packing *haricot* beans for export, and British American Tobacco (BAT), which processes tobacco for the domestic market and purchases it from over 10,000 outgrowers.

II.3 Structural Adjustment and Foreign Direct Investment

During the course of the 1980s, increasing numbers of SSA countries have adopted structural adjustment programmes (SAPs). In this section we first briefly survey the overall costs and benefits of FDI, especially in the era of falling foreign investment inflows, and then highlight some more specific issues directly and indirectly related to foreign investment arising from SAPs.

II.3.1 Costs and Benefits of FDI

Foreign investment brings to an economy a range of potential benefits. For SSA the main ones (although not applicable to all investments) would include the following: an expansion in productive and technological capacity, an increase in skill levels and employment, lower foreign exchange costs of goods now produced and previously imported, and an increase in foreign exchange earnings for goods exported. Positive "second round" effects would include the following: increased local demand, and therefore a boost to further production and an encouragement to further foreign and domestic investment. Foreign investment, however, can also be a bearer of potential costs as well as benefits.

Estimates of the aggregate impact of FDI on the economies of SSA are necessarily vague, partly as a result of lack of data. Nonetheless, it would appear that production directly attributable to foreign-owned assets in the mid-1980s contributed close to 20% of the GDP of many African economies. This is significantly lower than the comparable figure for the 1960s and early 1970s, in

large part as a result of the nationalisations of foreign capital carried out since that time. In the case of Nigeria, the contribution of FDI to GDP fell from about 40% in 1976 to 20% in 1986. Yet in the case of other countries, such as Gabon and Botswana, the figure remains much higher.

This relatively high and continuing contribution of FDI to growth, however, has increasingly tended to be at the expense of negative flows on the balance of payments. With the exception of mineral extraction and agricultural plantation investment geared to exporting, most FDI has been concentrated in import substituting industries. Although this was designed to replace imported products, most import-substituting industries have in turn had a high ratio of imported to total material inputs. Thus in Nigeria in the mid 1970s, the ratio of imports to total industrial supplies was about 90% for five major industrial sub-sectors, ranging from agricultural machinery fabrication to textiles (Onimode *et al.*, 1983, chapter 3). In Côte d'Ivoire in 1975, in the case of seven out of 15 categories of enterprise where FDI exceeded 50% of total production, the value of imports was greater than the value added within Côte d'Ivoire (Mansini *et al.*, 1979).

Once a certain and substantial stock of foreign investment committed to import substitution on this basis has been established and exports remain minimal or non-existent, it is inevitable that FDI will generate net costs in terms of the current account of the balance of payments. Further, the evidence in SSA suggests that it is very unlikely that inflows on capital account, in the form of new equity investment, will offset these negative outflows other than for an initial period and in exceptional years. It may, of course, be argued that in the absence of the import substituting FDI, the volume of imported goods would be greater and so this type of investment simply substitutes one type of foreign exchange outlay (repatriated investment income) for another (imported consumer goods). Yet the high dependence of most import substituting industrialisation on imported intermediate goods means that in practice there has been a twofold foreign exchange cost in terms of both investment income and imported inputs.

Côte d'Ivoire provides a good example of the balance of payments problems of an accumulated stock of such foreign equity (Riddell, 1990a in Riddell *et al.*, 1990c):

In every year from 1965-84, the outflow of profits, dividends and remittances exceeded the inflow of private capital, quite dramatically so in the post 1975 period. Indeed in the more recent 1975-1984 period, this outflow totalled Fr. CFA 1.1 bn,

16% of total export earnings and an amount greater than the total new inflow of private capital in the period from 1965-84... (Even without the rising outflow of remittance payments, the net effect of private capital inflows, when counter-balanced by profit and dividend outflow, only assisted the balance of payments in eight years out of 20 from 1965-84. Over the entire period 1965-85, there was a net outflow of Fr. CFA 100 bn.

Similarly in Kenya from 1981 to 1988, one source, based on official figures, has suggested that the net inflow of long-term capital (including reinvestment) slowed to a total of K£20 mn; but with an outflow of international investment income (from previous inflows) of K£1,325 mn, there was a net total outflow of over K£1,300 mn, equivalent to \$1.75 bn (Coughlin in Riddell, 1990c:245-6).

Besides the foreign exchange impact, there is the question of skills transfer. There is no doubt that the impact of FDI on the overall level of technical skills in the community is difficult to assess. Yet, given the normal turnover in an industrial labour force, one indicator of the impact of FDI on technical skills would be the size of the workforce in enterprises where FDI has a controlling interest. In fact the aggregate numbers employed in this sector are quite modest. For instance, in 1985 in Kenya, foreign-owned enterprises employed about 7% (82,000) of the 1.1 mn formal sector employees (Government of Kenya, Economic Survey 1987:41).

However this apparently fairly low number of directly employed wage earners is offset in Kenya, as elsewhere, by several other considerations (see King, 1977). First, the normal turnover of this labour force is sufficient to ensure that a certain proportion, with varying levels of skill, is distributed throughout the informal sector, as well as being available to new corporate enterprises. Second, many of the materials with which informal sector entrepreneurs work, such as scrap metal, textile waste and timber, are recycled - often illicitly - from large scale industry. Third, many of the self-employed "informals" continue to work in formal sector industry for several months at a time, when labour requirements are highest. Finally, much of the construction industry depends on formal sector companies subcontracting at least half of a total work programme to informal contractors,

many of whom in turn use tools produced by other members of the self-employed workforce.⁹

On the other hand, the impact of FDI on the development of management skills within enterprises has not been particularly favourable. In 1971 in Kenya, only 23% of executive or managerial posts in all U.S. owned companies were held by Kenyan citizens (Nzomo, 1971), while by 1982, less than 60% of managers and administrators in the entire (foreign-dominated) manufacturing sector were Kenyans (Kim, 1985:23). In 1978, in Côte d'Ivoire only 34% of senior posts were held by Ivorians, while even at the level of skilled artisans 30% of the posts were still held by expatriates (Campbell, 1983). Although the process of indigenisation of skills has advanced in the intervening decade in some countries, many African executives of companies effectively controlled by FDI still do not have a sense of taking responsibility for major decisions. What is more, 1984 data for Côte d'Ivoire (published in 1988) reveal that Ivorians constituted only 51% of senior personnel in industry, and they were in a majority in only 6 out of 16 industrial sub-sectors (Ministère de l'Industrie, 1988).

In summary, therefore, caution has to be exercised in assuming that the intended benefits of FDI on the economies of SSA have arisen in practice. Whilst making an important contribution to growth, FDI has frequently had a negative impact on the balance of payments, made only a modest contribution to generating employment, and done much less than it could to develop a *cadre* of local executives.

II.3.2 Disappointment in the Short Term

The long-term objective of structural adjustment programmes (SAPs) is to raise the productive capacity of the economy through both macro-economic and institutional intervention. Such intervention is intended to create an environment in which both domestic and foreign private investment can flourish. Yet in the

⁹ Yet even within the Kenyan experience the evidence appears to be contradictory. Thus, in a study of 20 subsidiaries of foreign companies, Gershenberg (1983:21,31) reported that "in no case did we find firms undertaking to assist in the development of local suppliers", and concluded that "subsidiaries of multinationals, while not opposed to using local sources, neither seek out local suppliers nor do they contribute to the development of local sourcing".

short, or even medium term, the evidence suggests that it is unlikely that the typical SAP "package" will have an overall incentive effect on FDI - even if it may be positive in the longer term.

Concern about the short-term effects of SAPs on FDI has been reflected recently in the International Finance Corporation's (IFC's) Annual Report for 1989, which comments thus (IFC, 1989:23):

A number of African countries have embarked on economic and institutional reforms. These reform programmes often make the business environment more difficult in the short to medium term by introducing the need to adapt to more competitive circumstances. Furthermore, measures aimed at reducing deficits often result in restrained overall demand and depressed local markets. Many businesses find it difficult to adjust to trade reforms and industrial restructuring measures and to absorb increased input and debt service costs caused by local currency devaluations. In this kind of environment, investors adopt a wait-and-see attitude before making new investments or expanding operations. In the long term, however, the success of such reforms should increase the scope for private sector activity.¹⁰

The potentially unattractive character of SAPs to FDI (in the short term) can be seen from a breakdown of the key components of typical adjustment programmes. These have included the following:

- the removal of import quotas;
- tariff reduction;
- the introduction of positive "real" interest rates;
- a revision of energy prices;
- a revision of agricultural prices;
- an introduction of energy conservation measures;
- a revision of industrial incentive schemes;
- introduction of policies to increase the efficiency of public enterprises;

¹⁰ In its 1990 Annual Report, similar comments are made about the negative effects of structural adjustment policies for investment in the short term, as well as the hoped-for revival in the longer term IFC (1990:19).

- improving support for agriculture (marketing, etc.);
- improving support for industry and sub-sectors (including the removal of price controls).

This list excludes depreciation of the exchange rate, which has been a common feature of most structural adjustment lending packages, and some devaluations have been severe in the extreme. Thus in Ghana the value of US\$1 fell from three to 30 Cedi in 1982-3, the value of the Tanzanian shilling fell by over a half in 1985/6, Sudan devalued by 40% in 1984/5, and in Zambia, US\$1 fell from 2.74 kwacha in 1985 to 16 by October 1989. A "one-off" devaluation would be an encouragement to foreign investment. In practice, however, even in cases where devaluations have been quick and severe, they have often been followed by further depreciations of the currency. Such action and uncertainty encourages potential investors to continue to wait for further falls in currency value before committing their funds.

A reduction in protection in import substituting industries through lower tariffs is likely to result in lower sales on the domestic market and, especially if this occurs, a squeeze on profit levels of relatively uncompetitive manufacturing enterprises. Significant depreciation of the exchange rate makes imported inputs more expensive, while the upward movement of interest rates tends to erode the opportunities for cheap local borrowing, which has been convenient to many offshore investors. An increase in energy prices, and in the price of transport and other services, has the same adverse effects on current and expected profit flows.

Côte d'Ivoire provides one, important,¹¹ example of how such conditionality has been applied at the level of an individual country. The key elements of the package lying behind three SALs made to Côte d'Ivoire in the 1980s have been:

- (a) a reduction in tariffs, with the objective of creating a uniform 40% across-the-board tariff;
- (b) the abolition of quotas on imports and of *valeurs mercuriales* (additional *ad valorem* taxes);

¹¹ Important both because much time and care have been taken by the Bank in designing the policies for Côte d'Ivoire, and because of the length of time that SAPs have been in operation in that country.

- (c) the introduction of across-the-board export incentives to counteract the new tariff regime and the effect of the high real exchange rate resulting from membership of the franc zone; and,
- (d) a revision of the investment code, including, specifically the abolition of tariff exemptions for priority firms, and the revision of certain fiscal measures (such as the extension of VAT to the first processing of raw materials).

In the years 1981-88, net FDI into Côte d'Ivoire (largely reinvestment of existing companies) totalled \$295 mn (\$37 mn a year), compared with \$425 mn (\$53 mn a year) in the period 1973-80 (IMF, 1989:310-311 and World Bank 1989c:112-113). This is not to argue that it was the structural adjustment programs which were the cause of the drop in foreign investment - clearly the issues were far more complex. Nor is it being suggested that the marked contraction in foreign investment inflow would have been reversed if these policies had not been followed: the aggregate trends could have been equally as adverse. Rather it is to suggest that the climate of 1980s, to which structural adjustment programs made a significant contribution, was such as not to encourage the further inflow of private capital.

Broadly, the reaction of most holders of FDI already in Africa to SAPs has been primarily one either of "wait and see" or of withdrawal. Bennell's study on British investment in the industrial sub-sector reveals substantial withdrawal, while a recent survey of French investors already present in Africa revealed little enthusiasm for expansion (West Africa, 11 June, 1990). Both aggregate and country-specific data suggest at best a slowing of foreign investment inflow, at worst a net outflow. On the other hand, the programmes put in place in the 1980s have generated a substantial interest within the international private sector in short-term trading deals, which take advantage of the relative freeing of the market in foreign exchange. Overall, however, and to date, whilst SAPs may have certainly encouraged certain types of short-term international private sector operations, they have not reversed the overall trend to disinvestment, and, in certain instances, may have accelerated it. Perhaps the classic case is Ghana, where there has been minimal new foreign investment interest after the country has pursued one of the most vigorous structural adjustment programme in the whole of Africa, and one in which foreign investor involvement had been expected.

What remains uncertain is whether further attempts to address the particular problems of the African economies - such as the over-extended state, bureaucratic inefficiencies, a wide range of administered controls, financial and other infrastructural constraints - will eventually lead to the anticipated injection of new capital or not. Certainly such reforms considered in isolation should attract foreign investment. But there are other issues which foreign investors will consider. For the primary sectors, and especially for import-substituting ventures, there would appear to be little optimism: given the macro-economic objectives of SAPs, it remains difficult to see how their main content can be preserved but their disincentive to FDI offset.¹² For export-oriented industries, however, there would appear initially to be some grounds for greater optimism. Although to date the overall impact of new foreign investment in these areas has not been marked, it is possible to record some successes. These would include, for instance, fishing, poultry and plastics ventures in the Gambia, and textiles in Lesotho. Further, a crucial element in the decision to invest is the potential investor's overall assessment of the country in question. The short term impact of SAPs in small, low-income countries is now well defined. The total effect tends to create an image of unstable prices and a changing institutional environment in which it is advisable to exercise caution. The prevalence of capital flight amongst those with saving reinforces this image. If a decision to support a project is taken, the preference will be for a minimal involvement through one of the various forms of NFI.

Two worries persist, however. The first is that substantial export successes have also been recorded in countries in which formal SAPs have not been adopted, as the examples of a wide range of companies in Zimbabwe and the INDECO group in Zambia testify.¹³ The second is both more general and more serious. Recent studies in foreign investment in developing countries suggest that a low-wage regime is a far less important incentive for location in a developing country than in the past. As Lütkenhorst (1988) comments:

¹² In Ghana, money supply restraints prescribed by the IMF to curb inflation have had an impact but at least initially led to shortages of liquidity, affecting at least domestic investment in manufacturing.

¹³ INDECO's exports in 1989 totalled \$32 mn. For details of the expansion of Zimbabwe's manufactured exports see Riddell (1990b).

Key factors in steering what has become a thinner flow of FDI to developing countries are skill levels, market size, the existence of an efficient industrial support network, the availability and quality of various support services as well as advanced telecommunication and information-processing facilities. Whereas previously a certain physical infrastructure (transport facilities, energy and water supply) was often sufficient to attract FDI, now a highly developed human and technological infrastructure would appear to be required.

What this suggests is that the presence of a stable (and expanding) domestic industrial base together with access to if not a domestic than at least a reliable regional market are becoming increasingly important factors in decisions of foreigners to re-locate into developing countries. This provides a counter to the view that investors are likely to be attracted in significant numbers solely to invest in industries geared to the export market, even if they have in the past.

There are other new features of foreign investment to which reference should also be made. For instance much has been made in the literature of the opportunities presented through the offering for sale of state or parastatal enterprises. Much more publicity has been given, however, to the "for sale" notices¹⁴ than to the evidence of "sale completed": foreign investors have, in general, not been particularly attracted by this new area of involvement, although examples of new foreign involvement would include bottling companies in Guinea,

¹⁴ Ghana, for instance, has named over 30 domestic companies for which it has sought foreign purchasers. In March 1990, Nigeria named 67 companies, while, in the last few years, other offers have included the following:

marble;	Togo	- steel, textiles, oil, agricultural implements, plastics,
	Liberia	- oil refining (in some doubt);
	Cote d'Ivoire	- agro-industry, trade, distribution public works and tourism;
	Congo	- cement;
	Nigeria	- chemicals;
	Sudan	- agriculture, manufacturing (announced June 1988);
	Liberia	- petroleum refining;
	Cameroon	- banana plantation;
	Ghana	- palm oil;
	Rwanda	- matches;
	Guinea	- soft drinks.

railways and sisal plantations in Tanzania and cotton in Mozambique. Perhaps the earliest example of state "sell-offs" to the private sector was that of Togo. Of the 19 enterprises originally earmarked for state divestment in the early 1980s, five had still not been disposed of by October 1990. Of those that have been sold off, some certainly have been the subject of foreign interest, although it has been usual for this involvement to be married with substantial aid finance and international finance corporations.¹⁵ The plastics company Industrie Togolaise des Plastiques was still failing to make a profit three years after new ownership and radical re-organisation, while the Kara plant of the Industrie Textile Togolaise and Togotex was standing idle in May 1990 after re-purchase "as a virtual gift" by a Hong Kong investor after the original Spanish and then Korean investors pulled out (West Africa, 11 June, 1990). Even the so-called success story, Société Togolaise de Siderurgie (STS), was operating in a far from internationally competitive environment: behind tariff protection of 4%.

One of the main purposes of the move to privatisation has been to raise the efficiency of state or state-related operations.¹⁶ In these cases, the capital-supplying role of foreign investment is less crucial. In some circumstances, where either the foreign partner or the government have not been in favour of full privatisation, other modes of involvement have occurred. For instance, Booker Tate has indicated its preference for management agreements with fees fixed in relation to levels of output and/or exports. Zaïre is an example of a country which arranged management contracts for its airline, copper and gold mines, after failing to attract equity participation.

¹⁵ Nioto, the country's food oil production company, was sold in 1987, with 51% of its shares going to the French CFDT. Much of the initial CFA 6 bn investment came from French aid funds, although in this case there has been a marked improvement in production.

¹⁶ One needs, however, to be wary about making *a priori* judgements about the absolute efficiency of private over public enterprises, or the relative efficiency of foreign over domestic capital. In a recent study, Grosh (1990) provides evidence to suggest that in Kenya's manufacturing sector, public and quasi-public firms perform better than private firms, while a World Bank study (1989d:35) in Zimbabwe reveals a higher rate of return on equity from local than foreign companies.

Another feature has also been for new investors in some parts of Africa to take over the investments of others who wish to withdraw.¹⁷ Again, publicity for this phenomenon needs to be laid alongside the question of whether there has been any new equity inflow. Certainly there are examples of foreign exchange gain through expanded exports and of expanded domestic investment subsequent to the takeover. Thus, following the \$14 mn purchase of Olivine Industries by H.J. Heinz in Zimbabwe in 1982, Heinz announced in 1988 its plans to increase its investment to Z\$260 mn by 1994. Most of this, however, is investment from its Zimbabwe dollar earnings.

Finally, much publicity has also been given to the new phenomenon of debt-equity swaps. These have spread to such an extent in recent years that one commentator (Parhizgari, 1988) has claimed that "today, most corporations that wish to invest in debtor nations can do so by buying debt for investment at a discount" (Page and Riddell, 1988). Debt-equity swaps have certainly been important in some Latin American countries. The much smaller weight of commercial debt in African liabilities has, however, limited their applicability to African countries, and even countries such as Nigeria, which have attempted to pursue debt-equity packages, have been singularly unsuccessful.

11.3.3 Improvements to the "Enabling Environment"

Just as it would be erroneous to conclude that no new investment had flowed to SSA during the 1980s, so too it would be incorrect to argue that the macro-picture reflected a backdrop of policy inactivity or hostility to foreign investment. As the following paragraphs indicate, significant policy changes have been occurring, especially in the post-1983 period, which together have improved

¹⁷ Instances of TNC replacement investment would include Norsk Hydro's 1988 investment in the fertiliser industry in Zimbabwe replacing South Africa's African Explosives and Chemicals Industries (AECI), Lonrho's participation with the government for the purchase of Consolidated Textiles, also in Zimbabwe, the purchase by Rhône Poulenc Sante of France of West German interests in the Société Industrielle Pharmaceutique de l'Ouest Africain in Senegal and the purchase by the Netherlands' Billiton International Metals of an 80% stake in the Twangize gold deposits held by Belgium's Société Minière & Industrielle du Kivi in Zaire. Additionally, there have been opportunities for foreign firms to take over all or part interests in local private companies, as happened for instance in early 1988 when DAF Trucks of the Netherlands took up shares in Kabwe Transport in Zambia.

the overall climate and potential for foreign investment. Many of these have been undertaken in the context of SAPs.

The 1980s, and particularly the last six years, have witnessed two important and accelerated changes in SSA. First, growing foreign exchange shortages across the continent brought to prominence in the eyes of policy makers in Africa the advantage FDI brings in the form both of increased inflow of foreign exchange from the initial investment and of the earnings of export-oriented enterprises, where relevant. This in turn led increasing numbers of governments to reduce or eliminate the hostility towards foreign companies which many had cultivated in the post-independence period.¹⁸ These moves, however, need to be placed in the wider international context. Thus, in general, Latin American and Asian countries began to end their controls or restrictions on FDI in 1976-7, well before the second oil price rise, or the recession of 1980-2 and the debt and financing crises, supporting the view that the need for foreign exchange was not the principal motive for their change in policy.¹⁹ The fact that other countries have also changed their policies - and in many cases earlier than in Africa - must, therefore, diminish the impact of the African changes, especially as the 1980s have also seen a marked fall in net private investment flows to Latin America (see Table 2).

Nonetheless, two specific types of policy change towards FDI can be highlighted. First has been the decision to participate in international investor insurance schemes, specifically through signing agreements promoted by the US' Overseas Private Investment Corporation (OPIC), or the joining of organisations, such as the Multilateral Investment Guarantee Agency (MIGA). As the former, in particular, is seen as a *sine qua non* for most US investors to look at all favourably at a country, it forms an important part of the perception potential investors have of Africa and particular African countries. Almost all African

¹⁸ In the post-independence years, Ghana, Guinea, Nigeria, Tanzania, Zaire and Zambia introduced restrictions on the access of foreign investment to some sectors, while price controls, labour legislation and foreign exchange restrictions all affected foreign investors particularly strongly.

¹⁹ It is not being argued here that all Asian countries have been welcoming to foreign investment. Besides the obvious examples of China and India, Indonesia, for instance, has severe restrictions on the sectors in which foreign companies may operate.

countries have now become signatories of OPIC; the membership of the more recently formed MIGA remains smaller, while it is still premature to assess its impact. Second, increasing numbers of African countries have either introduced or made substantial changes to their investment codes and/or guidelines which provide both the initial entry point and overall framework for doing business in these countries. A major component of these changes has involved speeding up the decision-making process, often with the introduction of a "one-stop" investment centre.

Between 1982 and 1987 more than one third of African countries either introduced or made adjustments to their investment codes or guidelines (often adopted in the period of post-independence hostility to TNCs) in order to attract foreign investors. Four recent examples of countries with already considerable foreign investment are Ghana, Nigeria, Kenya and Zimbabwe. In January 1989, Nigeria announced radical changes in laws affecting foreign investment, reversing the indigenisation decrees of 1972 and 1977. Foreigners are now allowed to be the sole investor in all enterprises with the exception of banking, insurance, petroleum prospecting and mining. In April 1989 Zimbabwe launched its new investment guidelines,²⁰ while in July 1989 Kenya's Investment Promotion Centre was overhauled.²¹ Even those countries with a reputation for hostility to private foreign investors, such as Mozambique and Guinea, have introduced new legislation offering a wide range of guarantees and opportunities for foreign investors.

While in each country these moves have been heralded as significant, it still remains doubtful whether these moves are in themselves sufficient to result in a major inflow of new foreign investment. In Nigeria, for instance, the decree (number 54 of 1989) giving the details of the new moves on foreign investment does not permit foreign companies registered under the old decrees (of 1972 and 1977) to increase their levels of foreign holdings; most were fixed at a maximum of 40%. What is more, informed Japanese opinion in early 1990 (from the Institute for International Trade and Investment) remained of the view that Nigeria still had to improve its investment incentives to "bring them in line with those prevailing

²⁰ Zimbabwe produced two publications: The Promotion of Investment; Policy and Regulations and the Investment Register.

²¹ This followed the launch of a new publication The Investor's Guide to Kenya.

elsewhere in the world" (report in the African Economic Digest, 5 February, 1990). A year after the "new" investment code was introduced in Ghana in 1988, it was apparent that its provisions were proving insufficiently attractive to investors and would have to be amended yet again - an action likely to instill further caution into the minds of potential investors as waiting could lead to even more favourable concessions being wrung from the authorities - while in March 1990, the government announced that company tax rates would be lowered - again. Both foreign and domestic investors in Zimbabwe have been unanimous in arguing that the new guidelines on their own are unlikely to make a major difference to the decision of potential investors to locate in the country, while in Kenya potential investors have expressed their fear that many of the proposals will remain on the drawing board, typified in the less-than-satisfactory manner in which price control measures have been "liberalised".

Related to these measures have often been the introduction or adaptation of other complementary incentives designed to make the inflow of new private funds more attractive, and to make it easier to utilise blocked funds for purposes of reinvestment. Such measures have included incentives traditional to foreign investment promotion like tax holidays (for up to 10 years), for example in Botswana, Lesotho and Mauritius, and removal of controls on remitting dividends, or a relaxation of rules on retaining export income, as has occurred, for instance, in Nigeria, Mauritius and Zambia.

Of the many examples of the favourable package of incentives now offered to foreign investors in SSA countries, the following, from Lesotho, are only typical of the most favourable:

- a ten-year tax holiday, extendable for up to 15 years;
- an advanced factory shell programme which offers serviced industrial buildings for immediate lease;
- access to concessional loans at 11-13% interest;
- access to foreign exchange and the repatriation of investment capital and earnings (profits and interest subject to 15% and 10% withholding tax respectively);
- a government sponsored skills training grant which covers up to 75% of the wage bill during the training phase;
- rapid processing of permits for foreign skilled labour required for the investment;

- an export financing facility to assist in alleviating cash flow problems in manufacturing for export.

These types of policy change need to be viewed against the backdrop of the macro-economic environment and overall government/state processes. In relation to the latter, investors are going to be interested in risking their funds only in a country in which the claims of attractiveness are matched by action. They will thus look for consistency in the manner in which past investors have been treated *vis à vis* the incentives offered, as well as the speed with which applications have been processed. As regards the macro-environment, besides the obvious desire for steady growth and a history of economic and financial management characterised by predictability, investors tend to view the relationship of the host country with the International Monetary Fund and the World Bank as a serious litmus test of confidence.²² For instance, in October 1987 the US corporation H.J. Heinz finally decided not to invest in Zambia after that country severed its connections with the Bank, even though a memorandum of understanding had been signed.²³

Countries where notable inflows of foreign private investment have occurred include Togo, Gabon and Mauritius - in the last case the number of firms operating in the Export Processing Zone has risen from 10 in 1971 to over 450 today. While recent changes in policies have been a factor here, perhaps a more important consideration has been long-term consistency in welcoming foreign investment. In other instances, more favourable policies in relation to particular sub-sectors have led to inflows of foreign investment into these sub-sectors; this would be true for Ghana following the introduction (in 1986) of its new minerals investment code. It needs to be stressed, however, that although it is usually necessary to improve both the general climate for foreign investment and the range of particular incentives in order to increase the inflow of foreign investment, it is not a sufficient condition.

²² During the 1980s, some 35 African countries embarked upon Fund-assisted adjustment programmes, yet less than a third "have pursued their adjustment efforts in a relatively sustained manner" (Nsouli, 1989:33).

²³ Heinz's withdrawal was due largely to the breakdown of Zambia's agreement with the IMF, particularly those aspects related to foreign exchange allocation and price controls. Earlier Zimbabwe lost a \$9 mn investment in the mining sector in part because of unexpected changes in the labour laws (Baker, 1983:27-28).

One recent indicator of the effect of these new policy initiatives on the inflow of foreign investment is provided by the number and type of new corporate investments supported by IFC in 1988 and 1989. This is summarised in Table 4, below. The figures appear to suggest an increased value in the aggregate investments supported. However in 1989, a single investment in petroleum extraction in Gabon, with a value of \$747 mn, accounted on its own for 72% of the total investment figure. If this project is removed from the list, the total value of investments falls from \$520.7 mn in 1988 to \$293 mn in 1989, and the proportion in the primary, or extractive, sector rises from 51% to 57%. On the other hand, whilst the total number of projects fell between these two years, the number in manufacturing - whilst very small in absolute terms - increased, if only from six to eight.

Table 4
Corporate Investments in Africa Supported by the IFC, 1988-9

Sector Projects	1988		Projects	1989	
	(\$ mn)	No. of %		(\$ mn)	No. of %
A. Primary	273.3	51.7	11	916.6	88.1 7
B. Secondary	196.8	38.7	6	106.1	10.2 8
C. Tertiary	50.5	9.6	3	18.1	1.7 2
Totals	520.7	100.0	20	1,040.8	100.0 17

Source: IFC Annual Report, 1988 and 1989.

III. PARTICULAR SUCCESSES AND PROBLEMS IN THE 1980s

III.1 Individual Examples against the Aggregate Trends

While it is clearly important to place major emphasis upon both the downward trend in aggregate foreign investment flows to SSA and the increasing divergence between SSA and other regions of the developing world, it would be erroneous to conclude that there had been next to no new private investment within the sub-region in the previous decade. On the contrary, investments by foreign companies have been occurring throughout the 1980s, some of which have made a impact if not upon a large number of countries of the sub-region, then at least upon developments within particular sub-sectors.

There are three sub-sectors which have been the subject of particularly visible attention by foreign private investors in the 1980s: mining, agriculture and the energy sector. Interest in the mining sector, as would be anticipated, has arisen principally in relation to minerals in which current and forecast prices are particularly buoyant. Thus, foreign investors have been most active in gold, diamonds and platinum, with interest additionally spurred on by uncertainty about the future of South Africa. Substantial disinvestment by US firms from South Africa would appear to have had a positive impact on mineral investment in other parts of Africa.²⁴

It is important, however, to place even this range of new interests into context. A large proportion of these have been in connection with the "new forms of investment" discussed in section I.2, above, or have taken place with "tied" funds of companies already located in particular countries. And even when new money is anticipated, it can happen that the "investor" delays committing equity by subscribing convertible loan stock (for example) rather than share capital.

A facilitative role in promoting FDI has been played by, among others, the International Finance Corporation (IFC), the Commonwealth Development Corporation (CDC), the Deutsche Finanzierungsgesellschaft fur Beteiligungen in Entwicklungslandern (DEG), the European Investment Bank (EIB), and the US Overseas Private Investment Corporation (OPIC). A whole range of packages has been

²⁴ Even if those firms disinvesting from South Africa have tended to leave the continent entirely rather than re-locate elsewhere on the continent.

designed, involving one or more of the following: local private investors, government participation, local or regional bank participation and the involvement of more than one foreign investor, with investment or management advice from the international agency. In some instances, the choice of whether to place equity capital in the venture can be delayed, thus minimising risk exposure even more.²⁵

Some recent examples of these sorts of foreign investment would include the UteXafrica textile project in Zaire, the Lonrho/IFC farm projects in Mozambique and the palm-oil refinery in Cameroon, of which the main shareholder, Société National d'Investissement (SNI) is not itself contributing financially.

In Zimbabwe, an injection of new funds into gold occurred at the start of the decade, when RTZ invested \$20 mn in the development of its Renco mine. More recently, the UK's Cluff Resources, having initially invested \$1.7 mn in gold, injected (in early 1988) a further \$8.3 mn into gold projects.²⁶ There have, too, been instances of re-investment and mineral exploration.²⁷ In Ghana, United States, Australian, Canadian, Irish and British (including Cluff) interests created a mini gold rush in the country in the second half of the decade, with more than 50 prospecting and reconnaissance licenses taken out from 1986 to early 1988. Guinea is yet another country in which there has been widespread interest in gold

²⁵ Thus in the IFC's "guaranteed recovery of investment principal" (GRIP), investors can reclaim the principal invested from the IFC if the project misfires, or take on the investment directly.

²⁶ Cluff's African investments have clearly been successful. In the words of the London Financial Times, they have "transformed the company from a loss-making minor oil-company into a profitable medium-sized gold mining group" (10 October, 1989).

²⁷ For instance, Lonrho (UK) and the Anglo-American Corporation (South Africa) have both reinvested in gold-mine operations in Zimbabwe, the Anglo venture being its first return to gold for over 20 years. Exploration for new deposits in the country has been undertaken recently by Delta Gold and Chase Minerals (Australia), while RTZ announced in January 1989 that it would be spending US\$16 mn (from retained earnings) on gold exploration in that year. Other international companies which have shown recent interest in gold in Zimbabwe are: Australian Seamet Mines and Consolidated Mining and Finance (Australia), Atlantic Resources and Kenmare Resources (Ireland) and Falconbridge (Canada).

in recent years, following the \$130 mn investment in the Aredor mine, 40% owned by the Australian Bridge Oil group.²⁸

A bullish diamond market, together with worries about South African supplies, has led to a substantial expansion of productive capacity during the 1980s, especially in Botswana, Ghana, Namibia and Zaire. It has also led to new investments by foreign companies. For instance, the Aredor mine in Guinea, which went into production in 1985, was by 1988 producing 1.5% of the world's gem diamonds and receiving the highest price for its production for any diamond mine in the world (Financial Times, 9 November, 1988).

Considerable interest by potential investors in platinum is now leading to major investment decisions being made. The most significant here has been the announcement in the second half of 1989 by the Australian group, Delta Gold, that its pre-feasibility study on the viability of a US\$160-200 mn platinum project on the Great Dyke in Zimbabwe had proved encouraging, so a full feasibility study had been commissioned, and the full project appears likely to go ahead.²⁹

Moving to agriculture, there is evidence of some new interest by private foreign capital in a number of African countries during the decade, although very little of this has involved the initial injection of new equity funds from outside Africa. Major projects would include, for instance, Del Monte's participation in the 1,500 hectare and \$8.3 mn investment in bananas in Cameroon,³⁰ Lonrho's \$7.4 mn investment to develop tea estates in Tanzania, Aberfoyle Holding's multimillion dollar Mwenezi investment in palm oil in Zimbabwe, and the 40,000 hectare palm oil investment in Ghana by four foreign companies, including Agricom Oil Products of Italy and Jamire Fats of Hungary. In Zambia, several major foreign investment

²⁸ It was also the presence of diamonds at Aredor which stimulated the interest of the Australians.

²⁹ It is estimated that 100,000 ounces of metal could be produced a year, and at full capacity the operation could in time rival production levels in South Africa. In a separate development, a joint venture of Anglo-American (South Africa), RTZ and Robertson Mining Finance (UK) was signed in May 1989, initially to commence a US\$2.5 mn exploration programme to extract some two mn tonnes of ore a year, while a third platinum investment project, put forward by Union Carbide (USA), is estimated at US\$120 mn, and includes both a surface and underground mine, producing eventually 5,640 kilogrammes of platinum a year.

³⁰ Del Monte's interest is mainly in the form of working capital since the land is rented.

initiatives to undertake large scale farming operations in the country were agreed in the 1980s, in large part as a result of the open enthusiasm of the President combined with a wide range of remittance, tax and foreign exchange incentives being introduced, including the option of purchasing foreign exchange credits of other foreign companies at significant discounts from the central bank.³¹ Two examples of new foreign investment would be Masstock of Ireland, which has initiated a \$10 mn investment package in a 25,000 hectare project in irrigated cotton and wheat production, while a similar \$55 mn package in the west of the country has been undertaken by a consortium headed by Lasco, the UK subsidiary of the US Lummus Industries.

The energy field is a example where reports of foreign activity need to be put into some perspective. While oil and gas exploration has continued in the 1980s, in spite of the decline in international oilprices, there has been such a fall-off in foreign interest that exploration activity has been inadequate for Africa to maintain its share of world production in the 1990s. However French, United States, Spanish, West German, Belgian, Italian, Japanese, British and Irish firms have been particularly active in response to projects in Angola (offering blocks for exploration and development), Sudan (on-shore drilling), Nigeria (liquified natural gas and oil), Gabon (drilling and exploitation), Equatorial Guinea (exploration and production) and Ghana (recent drilling). There has, too, been Irish investment in gas in Senegal and in on-shore oil development in Gabon.³²

Besides these three major areas of activity for foreign investors, there has been continuing interest in hotels and tourism. There has been a steady increase in the number of high-class hotels built in SSA in recent years, although this is attributable more to a marked expansion in worldwide tourism than because

³¹ It should be added, however, that these investments have also arisen in part because of the existence of particularly rich and unused water and land resources.

³² The failure of Liberia in its efforts to privatise the Liberia Petroleum Refining Company to Link Oil International of Dallas was said to be due to lack of government guarantees.

of any significant rise in conference business³³ or a dramatic upturn in overall economic activity in the continent. Active in the hotel business have been Sheraton, Hilton, Inter-Continental and the French Accor chain, together with Hong Kong interests in Mauritius.³⁴ However the involvement of these companies has been mostly in the form of management contracts: new hotels constructed in Africa in the 1980s have tended not to have been built with equity from these or other individual international equity sources.³⁵ Linked to the expansion of interest in hotels has been the growth in safari operations, which, since at least 1987, have reported record levels of business. Although a number of these projects have included foreign partners, they have usually not involved large-scale foreign investment.³⁶ An exception would be Kenya's South Korean-funded \$40 mn Safari Park hotel, which was completed in 1989.

Recent foreign interest in manufacturing has been stimulated principally by perceived potential for exports, spurred in particular by preferential access to international markets. Besides the development of the export processing zone in Mauritius, major investments have occurred especially in the textile industry, although these have largely been funded from reinvested profits or, in the case of Lesotho and Botswana, as a result of particular and unique circumstances in southern Africa. Lesotho has certainly attracted new private capital from Hong Kong, Taiwan and South Africa, not only as a result of an attractive and competitive investment climate but because of the skilful marketing of the state-owned Lesotho National Development Corporation, which has focused on preferential access to the European Community (EC), US and South African markets. The costs per

³³ The Harare-Sheraton, however, (completed in the late 1980s) was planned in large part in anticipation of its use as a conference centre.

³⁴ In August 1989 the \$50 mn Bissau Sheraton Hotel opened, bringing to 10 the number of hotels managed by Sheraton in Africa. The Gaborone Sheraton was planned to open in 1990, to be followed by one in Mauritius in 1991. In September, Yaoundé's Hilton International Hotel opened, with Hilton International having solely the management contract.

³⁵ An exception is the announcement made in May 1990 that the Sheraton Management Corporation was to take taken a (minor) equity share-holding in the \$50 mn Nairobi Sheraton hotel. This will be the 12th hotel in Africa under Sheraton management.

³⁶ Zambia Airways, for instance, operates a successful safari business for foreign tourists, called "Africa Bound".

job created in Lesotho, however, have been high.³⁷ In West Africa, duty free access to the EC market was the principal reason why two Togolese textile factories were purchased by a South Korean/North American consortium in 1987, although, as noted above, the Kara plant is now closed. It also lay behind the announcement of plans to establish a duty-free manufacturing zone, a project backed by a group of US investors under the *aegis* of the US OPIC and the IFC. Exploiting the EC market has been a major reason for the over \$35 mn programme of modernisation and expansion of Lonrho's David Whitehead textile company in Zimbabwe, while new investment in the Botswanan subsidiaries of both Whitehead (Zimbabwe) and Zimbabwean-owned Cone Textiles was based on further penetration of the South African and GSP-favoured US market as well as that of the EC.³⁸

The Lonrho/Whitehead example is one of the many instances of investment funds coming from retained earnings of companies already present in SSA. As noted above, this probably amounts for well in excess of half the "new" investments taking place in SSA in the 1980s. There are other particular examples of significant investments being undertaken or planned by TNCs with a long history of involvement in Africa. In Nigeria, for instance, in the second half of the decade, the United Africa Company (UACN), John Holt, Johannes Rau, Metal Box and Dunlop have all either expanded their operations or moved into new areas of activity, but very little or no new external equity funds.³⁹

III.2 The Nigerian textile industry: a case of import substitution

The Nigerian textile industry provides an important example of the growth of an industry geared to the domestic market but heavily dependent on imported

³⁷ Lesotho's manufactured exports tripled from M58 mn in 1986 M145 mn by 1988.

³⁸ Zimbabwe's textile exports rose from Z\$14 mn in 1983 to Z\$53 mn by 1987.

³⁹ Dunlop Nigerian Industries' new expansion plans were valued in 1987 at \$37 mn, while UACN's large-scale farm project investment was valued at \$28 mn in 1985. Similarly, in Kenya the Del Monte subsidiary, KCL, is involved in a \$25 million investment and expansion programme. In Zimbabwe TNC subsidiaries like Lever Brothers and Leibigs, Lonrho, RTZ and Hoechst have all reinvested over \$10 mn in the past few years, while the Anglo-American Corporation reinvested over \$150 mn between 1980 and 1986.

raw materials, which has been largely financed by FDI. Its dependence on imported raw materials, in the very difficult context of Nigeria's structural adjustment programme (SAP), has meant that it is now experiencing a serious recession; when it will return to a path of growth is very uncertain. As a result, it is unlikely that the existing offshore shareholders will make new commitments of capital in the foreseeable future. Since much of Africa's existing stock of FDI is concentrated in loosely comparable protected industries, the Nigerian textile industry provides a significant example of the problem of attracting new investment.

The industry was initially developed in the 1960s, when a series of companies were established, as shown in Table 5. In eight out of these ten cases, the offshore shareholder held a controlling interest, in most cases of close to 100% of the equity. By the 1980s the size of the industry had grown considerably, although 22 mills still accounted for 70-80% of total capacity. Their activities cover spinning, weaving, bleaching, dyeing, printing and other forms of finishing, and extend to man-made fibres as well as cotton.

The rapid rate of growth achieved by the sector from 1960 to 1982 (averaging 12.5% a year) was greatly facilitated by high levels of protection. In 1965, tariff rates on comparable imports were 76% for spun yarn, and close to 200% on bleached and printed finished products. By 1980, the industry employed a work force of about 70,000, and was the second largest employer of labour in Nigeria, accounting for 22% of manufacturing value added. Although the Enterprises Promotion Decree of 1977 had restricted foreign equity holdings in the sector to 60% of issued share capital, the offshore shareholders did not take the opportunity of the many successful public flotations held at that time to allow their share of equity to fall below this level. In fact, they continued to provide increased quantities of debenture loans sourced from offshore.

The major recession in the Nigerian economy after 1982, initially caused by the fall in the oil price but followed by the subsequent period of adjustment, caused a collapse in the production of woven fabrics, from, for instance, 655 mn metres in 1982 to 275 mn metres in 1985. Production remained close to this level up to 1989. The production of spun yarn has also fallen by a comparable amount. In response, the government has sought to encourage the industry to increase the local sourcing of its inputs. Some small increase in the volume of cotton lint purchased within Nigeria has been achieved, and there is a longer-term hope that the petrochemicals industry will produce fibres as a by-product, but this is

Table 5
Initial Foreign Investment in the Nigerian Textile Industry

Company	Year	Domicile of foreign shareholder
Kaduna Textile Mills (KTM)	1958	UK
Nigerian Textile Mills (NTM)	1962	Italy/US
Norspin	1963	UK
Arewa	1964	Japan
United Nigerian Textiles (JNT)	1965	Hong Kong
Textile Printers of Nigeria	1965	Japan/UK
Nortex	1963	Sudan
Zamfara	1965	Sudan
Aba Textile Mills	1964	USA
Asaba (turnkey)	1965	UK

Source: Ohiorhenuan and Poloamina (1989).

surrounded by uncertainties.

In 1987, the total retained earnings and reserves of the 22 leading companies of the industry were estimated at N312.4 mn (on an equity stock of N107 mn). The majority of this represented an asset for overseas shareholders, and at that time was valued at \$84 mn, at the official exchange rate. By January 1990 the value had fallen to \$39.6 mn (or \$31 mn at the parallel market exchange rate). Given this halving of asset values, the prospect of continued problems in sourcing inputs and very slow growth in real incomes, it appears unlikely that the Nigerian textile industry will continue to attract FDI as it has done in the past. It provides a sombre example of the fate of much FDI in import-substituting industry in SSA.

III.3 Export Processing Zones

One approach to attracting FDI which is frequently discussed and now advocated in Africa, as in other parts of the developing world, is the

establishment of Free Trade Zones, where a combination of favourable tax regimes and efficient infrastructure can attract export-oriented investment. The two prime examples of this in Africa are in Senegal and Mauritius: the former has been rather unsuccessful, the latter spectacularly successful.

Three points characterise the Mauritian case. First, the country succeeded in initiating investments totalling about \$150 mn from 1976-86 in the Export Processing Zone (EPZ).⁴⁰ Second, this was distributed between about 400 different companies, and third, the combined exports of the EPZ totalled \$630 mn by the year 1987, accounting in that year for more than 60% of the country's total exports and thus replacing the traditional dominance of sugar. Foreign equity capital has accounted for well over half the total, as shown in Table 6.

Table 6
Foreign Share in Total Equity, Mauritius EPZ, 1970-85

Years	Total no. of firms	Total equity (Rs mn)	Foreign Participation (Rs mn)	%
1970-83	81	184	98	53
1983-85	102	241	165	68

Source: Lamusse (1989).

Yet there would also appear to be some exceptional circumstances about the Mauritian case. Thus a very high proportion of foreign equity capital came from Hong Kong, rising from 33% from 1970-6 to as much as 86% in the period 1983-85 (Lamusse, 1989:6 and Tables V-VII). The specific interest of Hong Kong capital in Mauritius results both from the presence of an active Chinese business community and from the need of the Hong Kong textile and garment industry to avoid the quota

⁴⁰ Rs1.5 bn from 1976-87, financed from foreign and domestic equity, as well as loan capital, and assuming an average exchange rate over the period of Rs10 = \$1. (See Lamusse, 1989: Table 8).

restrictions on exports built into the Multifibre Arrangement (MFA) on textile trading. The second, much smaller, source of investment has been France, nurtured by close links between the French-speaking settler community in Mauritius and metropolitan France. The preference of Hong Kong investors has been for a controlling equity interest, and their share has usually been between 80 and 100% of the total. French investors have generally preferred joint ventures with shares of between 35 and 80%. Thus the Mauritian EPZ has not been dependent on NFI type arrangements, but has succeeded in attracting a major financial commitment from its investors. A further important characteristic of the EPZ companies has been their ability to raise finance on the local market. Much of this was provided by the sugar industry, which sourced 44% of the local equity capital from 1970-84.

None of this could have been achieved without a high degree of government support (Lamusse, 1989:32):

The incentives granted by the Mauritian Government have taken the form of duty-free imports of machinery, equipment and spare parts, raw materials, components and semi-finished goods, the construction of industrial estates, concessionary rental on electricity, water and other infrastructural services, including subsidised air and sea freight, free remittance of profits and dividends and free repatriation of capital (excluding capital appreciation); loans and export finance at preferential rates of interest from the Development Bank of Mauritius and commercial banks, and priority in the allocation of loan capital. In addition, the Mauritian Government has followed an "open door policy" vis à vis foreign investors: there is no restriction on foreign participation, and many EPZ enterprises are 100% foreign owned. Other incentives include tax rebates on the salaries of foreigners working in the EPZ and a constitutional guarantee against nationalisation.

Support of this kind, however, is in itself clearly not enough to ensure the success of an EPZ. In the case of Senegal, the fiscal package offered included total exemption from duty on all imported goods and materials, and exemption from all indirect and direct taxation until 1999 - that is for 25 years for companies establishing themselves in the zone's first year. Efficient infrastructural facilities were also developed, taking into account the experience of successful zones in other parts of the world. The zone was established in 1974, but by 1985 only seven firms were in operation there, all of which were exporting to the countries of the region, mainly those of the Union Douanière de l'Ouest Africain (UDOA).

Comparisons of the record of the Senegalese zone in relation to that operating in Mauritius appear to indicate that EPZs are likely to be successful only when certain special, particular ingredients are present. The experience of Mauritius, together with another success, Taiwan, suggest that these include the presence of a very dynamic local business community, which is in a position to form effective links with the overseas investors, and circumstances in which overseas equity can be complemented domestically by loan, if not equity, capital. In addition, the underlying structure of local costs must be competitive in world terms: fiscal concessions can only reinforce a cost advantage rather than offset a cost disadvantage. In the 1980s, Senegal has been at a disadvantage in the EC market as a result of the value of the CFA franc *vis à vis* most EC currencies. The evidence suggests that it will be difficult for most African countries to repeat the success of Mauritius in the development of an EPZ, although the conditions may exist in special cases. One of these could be the EPZ under development in Mombasa, Kenya. A basic difficulty is that even if one or two EPZs are successful, and perhaps Togo will be one, there is little to suggest that each sub-region in Africa would be able to attract sufficient foreign interest to support more than one or two of them. Finally, however, doubts have recently been raised about the durability of even the Mauritian success. Thus, since 1989, the performance of the zone has become increasingly disappointing: exports rose by only 4% in 1989 and forecasts for 1990 indicate no rise in this growth rate; employment expansion has all but halted, and the combination of high absenteeism and pressures to increase real wages are eroding the international competitiveness of the zone.

IV. FOREIGN INVESTMENT IN SSA IN THE 1990s

IV.1 Overview

As in other regions of the world, the prospects for private foreign investment in SSA in the 1990s will be related both to investors' perceptions of the opportunities within the country or sub-region, and an evaluation of these *vis à vis* opportunities prevailing in other parts of the world. At a general level, the prospects for SSA in the 1990s remain probably as poor as they did in the 1980s - and maybe even poorer. There is little optimism that substantially higher levels of real per capita incomes will be achieved, that the debt and foreign

exchange crises will be significantly eased, that the underlying infrastructural problems of transport and communication, as well as the shortage of key skills, will be solved in the short term. Overall, opportunities exist for investment related to the extraction and processing of those mineral and agricultural products for which price projections are bullish, and in some export-oriented manufacturing enterprises, but in general the SSA region is likely to remain less favourable to the inflow of foreign investment than many countries in Latin America and Asia.

Three new factors would appear to downgrade the ranking of the SSA region as a field for new foreign investment in the 1990s. The first is the formation of the single European market.⁴¹ In preparation for this there has been a significant relative increase in the flow of private investment to the member states of the EC as companies jockey for position, attempting to be better placed than their competitors to exploit the anticipated opportunities: there has been, and is likely to continue to be, an increase in investment in the EC of those currently trading with the EC. Both the focusing of attention upon Europe and uncertainty surrounding the post-1992 European Community mean that the early 1990s, especially, are unlikely to be a period when a major shift of attention to Africa by foreign investors will occur.

Changes in, and the probable expansion of, a more homogeneous EC market are by no means the only new factors confronting those seeking to promote an increase in inward investment flows to SSA. Clearly events occurring in eastern Europe and in the Soviet Union since mid-1989 should caution one against predicting even the seemingly obvious. Yet it is now widely anticipated that the new political order emerging in the countries of eastern Europe, as well as in the Soviet Union, will lead to the opening up of the economies of at least Poland, Hungary and Czechoslovakia. Already, these changes, together with the unification of the two Germanys, have not only raised the prospect for new private foreign investment inflow into these countries, but significant inflows of private investment are already occurring in at least Germany, Hungary and Czechoslovakia and there is every possibility that the pace and depth of interest in these countries will intensify in the next few years: many companies are already undertaking costly evaluations

⁴¹ In their substantial analysis of the issue, Davenport and Page conclude that "most of the implications for investment in developing countries appear to be negative (1990:59).

and analyses of opportunities.⁴² The interest already generated will act as yet another factor eclipsing the efforts of those wishing to encourage private companies to invest in SSA.⁴³

Thirdly, there has been growing awareness during the course of the 1980s of the economic importance of the east Asian region. Some US Government projections suggest that the region is likely to grow to be the largest single economic regional sub-grouping by early in the twenty-first century (if not before), exceeding in market size both North America and an enlarged EC. As a result, American and European companies especially have been focusing their attention increasingly in this area of the world, looking for both trade and investment opportunities - to the detriment of sub-Saharan Africa. This is likely to intensify as the 1990s unfold.

These trends themselves need to be placed alongside the perceptions potential foreign investors have of the returns likely to accrue from investments in different parts of the world. Figure 6, reproduced from the recent World Bank report on SSA, sends out two powerful messages. First, the rate of return on investment in SSA is extremely low - indeed lower than the current US prime rate, adjusted for inflation - having fallen steeply over an almost 30 year period. Secondly, the miserable rate of return on investment in SSA in the 1980s compares sharply and starkly with the high and growing (albeit marginally) rates accruing to investments in South Asia.

A major impediment to increased foreign private investment in Africa today remains the low level of domestic saving and investment.⁴⁴ Unless and until these ratios begin to rise and potential foreign investors see a greater domestic

⁴² What is more it is not only EC and Japanese companies which are investing in these countries, but also companies from countries which might be thought to look more favourably at investments in Africa. Thus the Indian hotel group Oberoi, have entered into a joint venture with Hungarhotels for a \$60 mn hotel investment in Budapest.

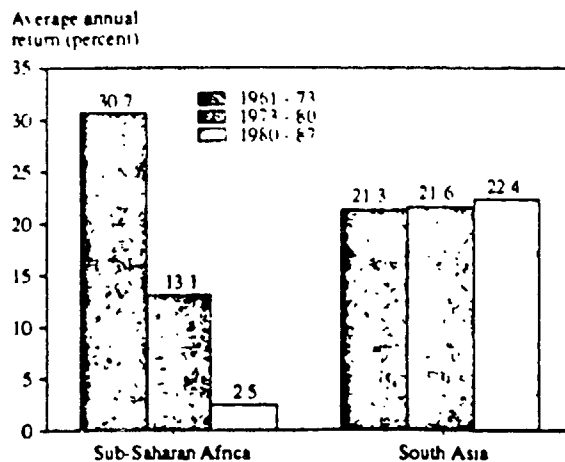
⁴³ If, however, there is rise in demand for tropical products in eastern Europe, this could stimulate world prices of these products.

⁴⁴ According to the 1988 World Development Report (WDR) (Table 5), the ratio of Gross Domestic Saving (GDS) to Gross Domestic Product (GDP) in all developing economies in 1986 was 24%, but only 11% in Sub-Saharan Africa, and the gross domestic investment/GDP ratios 24% and 14% respectively. Out of 35 African countries whose data were individually recorded in the 1988 WDR, only 11 had GDS/GDP ratios greater than 15%; for 10 countries the ratio was lower than 5%.

commitment to investment, it is unlikely that aggregate foreign investment will substantially increase. In this context, note should be taken of a comment made by the Vice-President of Equator Holdings which operates in 20 countries of SSA (quoted in Development Business, 15 March 1987, p.19):

The Africans keep talking about the need for a Marshall Plan for Africa or about the need for massive foreign private investment and our feeling is that the rest of the world has pretty much abandoned Africa as an attractive place to invest. Conditions are going to have to change to the extent that indigenous Africans see business opportunities, take advantage of them and demonstrate success. When they are given the scope in the economy to become productive, retain and reinvest the proceeds of their endeavours, that will attract the attention of the rest of the world. And to the extent that those opportunities are attractive, foreign investment will come in. But until Africans themselves can generate some kind of positive results in Africa, the rest of the world is certainly not going to pay much attention there.

Figure 6
Rates of Return on Investment
Sub-Saharan Africa and South Asia, 1961 to 1987



Source: World Bank (1989b:26).

The implications would appear to be grave. Aggregate direct foreign investment is unlikely to rise significantly in real terms, and certainly not to the extent necessary to bridge the gap between foreign capital inflows and the shortfall in investment funds required to raise economic growth rates. FDI as a

share of total resource inflow is likely to remain low - less than 5% - and play a minimal role in the important goal of raising the investment/GDP ratio in the countries of SSA. Even if the economies of SSA begin to grow at higher rates in the 1990s than they did in the 1980s, it is unlikely that this in itself will be a major boost to new inflows of foreign investment. The SSA region is characterised at present by very low levels of capital utilisation. Higher growth rates are likely to lead, both initially and for some considerable time, merely to higher levels of plant and machine usage.

IV.2 Change in South Africa

These brief contextual comments on the overall climate for investment in the 1990s would remain incomplete if mention were not made of recent and contemporary events in South Africa. Following recognised convention, the sub-region of sub-Saharan Africa excludes South Africa because of the world's abhorrence and condemnation of the *apartheid* and non-democratic political system. Yet not only has foreign investment played a significant role in the development of the South African economy, but its overall impact has been almost as important as for SSA as a whole. Thus in 1985, the total stock of foreign private investment in South Africa was valued at about \$11 bn, compared with only some \$23 bn for the whole of SSA; and in the period 1965 to 1974 the inflow of private investment to South Africa averaged \$190 mn a year.⁴⁵

Since the mid-1970s, however, there has been a net outflow of private capital, which accelerated from the mid-1980s onwards as a result, especially, of disinvestment by United States corporations: from 1976 to 1988 there was a net outflow of \$2.7 bn. This lack of investor confidence in the future of *apartheid*-ruled South Africa, together with trade and foreign financing restrictions, not only affected adversely the growth of the South African economy but also had ripple effects throughout the economies of the neighbouring states of southern Africa, severely depressing their growth rates.⁴⁶ What is more, the vast majority of investors who withdrew from South Africa left the continent completely.

⁴⁵ Data from Lipton (1988), IMF (1989) and Riddell (1988).

⁴⁶ For a discussion of the linkages between the South African economy and that of its neighbours see Lewis (1987).

The release of Nelson Mandela, the unbanning of the African National Congress, the willingness of the South African government to talk about the ending of *apartheid* and discussions about the inauguration of a political system based on universal suffrage raise the real possibility of a resolution of the South African conflict. Such an outcome could have a major impact upon the prospects for foreign investment not only in South Africa itself but more widely in other parts of the SSA area. Although much clearly remains speculative, the following factors can be highlighted:

- A political settlement in South Africa would not only bring positive world attention to that country but would provide the catalyst for investors to take a new and more "upbeat" look at the continent in general.
- If a political settlement in South Africa is achieved and (as has occurred in Namibia) a new government is installed that is on balance favourable to private foreign investment, private capital outflow would cease and substantial new foreign inflows to South Africa could easily occur.⁴⁷
- With or without new private capital inflow, once trade and financial restrictions against South Africa are removed, higher growth rates of the South African economy can be expected. These should boost regional economic growth and thereby improve the climate for private investment in the Southern African Development Coordination Conference (SADCC) countries. If foreigners do decide to increase their investments in South Africa, the possibility of ripple investment effects occurring in the rest of Africa should increase because a South African economy more integrated with the rest of Africa would provide the context for the exploitation of regional opportunities.⁴⁸

⁴⁷ Even members of the most radical wing of the African National Council (ANC) now argue for increased foreign investment. Thus in an interview with the *Financial Times*, Mr Joe Slovo stated (27 February, 1990):

Foreign capital will remain crucial to development, and guarantees of stabilisation and security will be offered to ensure investors do not avoid South Africa.

⁴⁸ Swaziland and Lesotho, however, which have certainly benefited from sanctions-busting investment, would be likely to be relatively adversely affected, at least in the short term.

Given the uncertainty of the changes in South Africa, it would be prudent not to incorporate too great a dose of optimism into the way that a "best-case" scenario might improve the overall climate for foreign investment in SSA in the 1990s. Yet pessimism at the aggregate level about the prospects of raising significantly the level of foreign investment in SSA in the 1990s by no means has to lead to the conclusion that African countries remain powerless to influence the level and degree of foreign involvement in the SSA region. Section III above highlighted a number of sectors and sub-sectors - in mining, agriculture, energy and tourism - in which foreign investors have been active in the 1980s against the overall trends, as well as providing examples of companies in other sub-sectors which have either brought in new funds or reinvested retained earnings. In general, these sectoral and sub-sectoral opportunities are likely to continue into the 1990s, while changes in perceptions of the future prices of mineral and agricultural commodities may well open up new and different opportunities for investment in other primary products.

IV.3 Improving the Investment Climate by Addressing Specific Constraints

It is widely assumed that future investment inflows will be directly related, minimally, to the package of direct incentives which influence the expected rate of return, the security of the investment and the scope and speed with which companies are able to disinvest.⁴⁹ The tax regime, the investment code or guidelines, and overall macro-economic policies, including those related to access to foreign exchange, domestic borrowing by foreign companies, the setting of prices, wages and employment regulations, are clearly all central elements which affect this overall package. Section III.2 discussed the manner in which these instruments have changed during the course of the 1980s in most countries of SSA to become more favourable for new foreign investment inflow and the productive use of retained earnings of already-established foreign companies.

There is every indication that these particular trends will continue, if not accelerate, during at least the first half of the 1990s, creating, broadly, a more favourable and increasingly welcoming attitude to foreign investment. In

⁴⁹ For a general discussion of the influence of general incentives in attracting foreign investment see Guisinger in Moran *et al.* (1986).

this context, particular note should be made of the following factors inhibiting investment where action is still needed:⁵⁰

- **Lack of formal legislative provision for foreign investment.** Although today it applies only in a minority of African countries, some governments have still not published investment codes or provided a clear-cut policy for foreign investment. In these cases foreign companies are reluctant to invest, in no small measure because of the greater likelihood that the host government will change the rules for foreign investors. Concern about the absence of fixed and certain legislation is one of the most frequent complaints of foreign investors: if legislation is changed, notice could be given and retro-active legislation strictly avoided.
- **Lack of legal infrastructure.** Some countries still lack up-to-date company legislation, and in these cases suitable amendments are an urgent priority. More widespread is the maintenance of traditional land tenure legislation; this can impede exploiting mineral and agricultural potential. For some products produced by foreign companies, current legislation is inadequate, or even absent, in relation to patents or copyrights. In some cases this is because countries without industries that depend on these have never seen the reason to develop such legislation. This is a deterrent to particular classes of investment, notably in pharmaceuticals and informatics, as well as to various types of technology transfer.
- **Price controls.** These are a major impediment both because they lower all returns on investment and because they create the need to secure government intervention for routine decisions. Some countries are also criticised for erratic and inconsistent policies on prices. This particular problem, together with restrictions on access to foreign exchange to purchase imported inputs into the production process, has been one of the most important obstacles to Japanese investment in Africa.

⁵⁰ Although not in all countries of the sub-region.

- (1) **Labour legislation.** In African countries this has been most often seen as an obstacle with regard to employment of expatriates, but where there are severe restrictions on hiring and firing of workers, these are likely to be seen as especially serious because they are an operational restriction, because they require companies to deal with unfamiliar legislation, and because they reduce flexibility when demand changes and thus increase risks.
- (2) **Taxation policy.** In general, taxation policy appears most important at the time of initial interest in investing (the point at which comparisons with other countries are made) and before operating conditions become relevant. Thus what is often important at this initial time is taxation policy in other countries: comparisons raise the threshold of what companies expect (Page and Riddell, 1988). As only a few industrial countries offer credit for tax not paid because of concessions under dual taxation agreements (FRG and Belgium among the principal foreign investors), concessions which may be beneficial to local investors could often be less valuable to foreign investors, as well as being costly to governments.⁵¹ Differentiated concessions more favourable to foreign investors are not generally regarded as favourable, because of the potential for ill-feeling, generally or by domestic investors.⁵²
- (3) **Foreign exchange controls, particularly on profit remittances.** As a general statement, it would appear that potential investors are unlikely to invest if companies present in the country are unable to repatriate their profits. Yet most countries in Africa still have

⁵¹ Some experienced recipients of foreign investment have argued that the time limit on tax concessions could inhibit further investment by existing companies unless carefully phrased, but in practice the advantages of familiarity may well outweigh this.

⁵² To the extent that foreign investment is itself influenced by whether domestic businesses are investing, such concessions would thus tend to be dosed with self-defeatism.

significant foreign exchange controls - not absent even in the CFA franc zone - as do many countries in other regions of the world. Thus what is important is the nature of such controls (or unexpected changes in them) and how they compare with any other countries a potential investor is considering. Exchange controls will tend to be especially influential if they are set with reference to the local currency value of the initial investment in a country with severe devaluations, or if they are part of an unusually tight package of restrictions on all outflows.

Particular problems still encountered include the following: the requirement that management and "know-how" fees should be denominated in local rather than foreign currency - thus exposing investors to exchange rate fluctuations; pressures for an investor to register a corporate presence in the host country - so as to register himself liable for local corporation and/or turnover tax; lack of clarification in the interpretation of corporate tax codes - opening up the possibility of taxes on dividends and fees being withheld at both the company and country level; high rates of personal tax on expatriate employees - or penal limitations on their remittability.

- **Exchange Rate Level.** The majority of African countries outside the CFA franc zone have devalued their currencies by significant amounts in the late 1980s. As a result, the potential returns to investments which generate exports based on domestic resources have improved, and these include returns from the crucial minerals sector. In the many cases where export-oriented projects are dependent upon imported inputs (such as yarn and even woven fabrics), however, the increased cost of these inputs needs to be set against the anticipated rise in export values. In the case of foreign investment in import-substituting industries, as we have shown in the case of Nigerian textiles, the effect of devaluation on an investor's existing portfolio is devastating. The long run benefits in the form of an increased efficiency in the utilisation of assets in the economy as a whole remain nebulous and intangible. The maintenance of the exchange rate between the CFA franc and the French franc at 50:1 has made the CFA

franc zone a crucial exception (concerning 14 out of 20 SSA countries) to the general pattern of depreciating currencies. For as long as the exchange rate is maintained at about this level, the value of investors' existing portfolios in import-substituting industries in the CFA franc zone will be maintained, though wider macro-economic problems will make incremental investment in these areas unlikely. At this exchange rate, however, new investment in export-oriented industries is likely to remain minimal, even with a high domestic resource component.

While the addressing of these specific problem areas should certainly help improve the investment climate and raise the prospect of greater flows of foreign investment, two notes of caution should be sounded. The first is that the anticipated positive consequences of further "liberalisation" moves are unlikely to make a major aggregate and positive impact, for the reasons spelt out in section II.3.2 above. The second is that, ironically, one of the traditional - and often powerful - attractions of Africa for the foreign companies which chose to invest there was the lack of competition. To the extent that monopoly or oligopolistic powers of potential investors continue to be eroded, these will tend to act as a counterweight to the investment-enhancing policies.

There are, however, other broader factors which influence the decisions of potential investors to locate within particular countries in the sub-Saharan region. The rest of this section examines a number of major impediments which, if addressed, would contribute to creating a more favourable climate for private foreign investment in the 1990s.

IV.3.1 The media

Africa, more than any other developing region, suffers from adverse media exposure.⁵³ The importance of the media in forming judgements about investment is well brought out from a 1980s survey on US perceptions on African investment:⁵⁴

Respondents were asked how they obtained their information in making their risk assessments and investment decisions. By far the main source of information on Africa for the business community is the mass media, primarily the press. Since the American press selectively focuses on trouble spots, impressions are more negative than positive. It is not unusual for executives considering investment decisions in Africa to be stopped dead in their tracks by a single unfavorable article. The chief executive officer of one American manufacturing company considering an investment in Zimbabwe reported, for example, that he had decided after reading two recent pieces in the press that the threat of civil conflict and a socialist ideology dissuaded him from further consideration of his project. He made no attempt to corroborate or probe impressions gained in the press, either through contacting US government agencies or sending a company representative to Zimbabwe to verify the judgement.

To the extent that these US-specific perceptions can be generalised, they suggest that even if the fundamental conditions for increased foreign investment are established, it will frequently be necessary to spend considerable effort, time and money on countering the negative view of Africa that is so prevalent. One way that this can be done is for host countries to build upon the successes of past foreign investment ventures, most particularly by using successful foreign firms as advocates among potential investors in their own home country, both for their investments and also for investing more generally in the SSA region. This particular area of investment promotion is comparatively easy to initiate as it is apparent that many foreign companies are themselves keen to take on such an advocacy role, as the following two quotations confirm, the first from the senior Vice-President of the US H.J. Heinz, the second from the chairman of the UK's Cluff Resources:

⁵³ For a readable analysis of the problem see Harrison and Palmer (1986).

⁵⁴ Quoted in Baker (*op.cit.*), pp.50-51.

Heinz must be prepared to develop an advocacy role for the developing country in which Heinz invests, to intercede on the country's behalf with the US Government and be prepared to put the country's best foot forward in order to attract potential investors among the developed nations.⁵⁵

Africa is in many respects highly preferable to the more popular exploration areas of the world, such as North America and Australia. Not only is there less competition in Africa but doing business is actually easier than it is portrayed. Far from being bedeviled by bureaucratic obstacles, we find that African politicians and civil servants are more approachable, more practical and more reliable than their counterparts in Canada, the US or Australia, for example.⁵⁶

IV.3.2 Skill shortages

A more specific impediment to increased FDI in Africa is that of skill shortage in the host economy. In many countries this shortage covers management and accountancy skills, but even in countries like Nigeria there is evidence that the shallow base of a wide range of technical skills leads to inefficiencies and low levels of productivity which deter foreign investors. This is also an area where foreign investors see a large gap between what the Asian and Latin American countries and the average African country can offer, not merely for specific skills but more generally in relation to basic education and familiarity with equipment. Companies that are accustomed to investing in other developed countries, or in Latin America or Asia, do not themselves have the organisation or experience to deal with countries with much more severe local skill shortages, and this perception does influence their view of operating in most African countries.

Skill shortages are particularly serious because they affect not only the setting up of foreign-funded plant and equipment but also its continuous operation and its adaptation to local conditions. There is little doubt, for instance, that the emphasis placed on technical training and planned maintenance schemes has been a major factor in the advance, diversification and competitiveness of the manufacturing sector in Zimbabwe. In contrast, the lack of planned maintenance

⁵⁵ Letter to co-author, 11 June, 1984.

⁵⁶ African Economic Digest, 11 December 1989. Cluff's attitude puts into perspective the view about the adverse factors in doing business in Africa. As the latter, negative, view is more widespread, the point reinforces the desirability of advocacy of the alternative view by those with first-hand knowledge of Africa.

schemes and shortages of engineers and related technical staff in the vast majority of African countries are important restraints on potential foreign investment, especially in the manufacturing sector, inhibiting the opportunities within Africa for launching export-oriented enterprises to penetrate Europe (under Lomé) and the US (under GSP preferences). As the problem becomes particularly visible when investors wish to diversify into new sectors, it acts as a major constraint inhibiting the "spread" of foreign investment away from those sectors to which it is initially attracted.

A related issue is frequently that attempts to redress the skill shortage problem through the importation of skills are frustrated because of restrictions and lengthy bureaucratic delays involved in obtaining work permits for necessary skilled foreign workers. This problem continues to concern foreign investors, for example, in the more advanced economies of Kenya, Nigeria and Zimbabwe. Addressing these particular constraints should thus be a particular priority for countries wishing to attract foreign investment.

IV.3.3 Inadequacies of the domestic infrastructure

A major impediment to foreign investment in many African countries has been and continues to be the poor state of the infrastructure. Poor or inadequately-repaired roads, delays in receiving or shipping goods on the railways, delays at the ports, faulty telephones, unreliable or unavailable telexes and telefax machines - important especially for export-related investment - have all led to low levels of efficiency in current productive sector investments and have deterred new investors. Although the disadvantages of poor transport and communications structures affect all investors, they are likely to affect foreign investors disproportionately. By their nature, they are more dependent on them than an "average" company.

As a result, potential investors are likely to look carefully at the degree to which the host government is allocating its resources to investment: if the infrastructure is in a poor state and, moreover, little or disproportionately low levels of funding are being allocated to infrastructural investment, foreign investment inflow is likely to be extremely limited. Where structural adjustment conditionality has led to a significant contraction of public sector investment, private sector investment has already been adversely affected. In contrast, well-

maintained and efficient infrastructure is certainly a factor which attracts potential investors.

To the extent that some areas of infrastructural investment have been and continue to be barred to private, and particularly to foreign, investment, there is no obvious way around such an obstacle, except through expanding infrastructural projects funded by external official assistance, or initiate build-own transfer techniques as practised in a number of middle-income countries in the Near and Far East.

IV.3.4 Bureaucratic delays and lack of decisions

Another common impediment to foreign investors has been and - in spite of some clear advances made in recent years - continues to be a range of factors associated with the administration and decision-making arm of the host government. These frequently begin in long delays - sometimes stretching into years - in obtaining the initial permission to invest in the country, even when the foreign investment conforms in every way with the respective investment code of guidelines. Thereafter, managers of foreign investment projects (frequently in common with their domestic counterparts) face numerous administrative hurdles which need to be overcome, often repeatedly, in order to operate their companies. These include matters such as obtaining licences to import and export products, seeking permission to hire and fire workers, obtaining approval to fix and raise prices, etc.

Some obstruction, as in any country, may be deliberate, particularly when foreign investors (who perceive themselves as powerful agents, especially when locating in a small country) try to obtain a concession or particular treatment without formal requirement. But much delay occurs because of inexperience or inappropriate procedures. This is particularly damaging to foreign investment because these investors are more aware of it, being familiar with procedures in other countries. They, too, have the choice of where to invest.

There is no doubt that the creation of "one-stop" investment centres is helpful in addressing at least the initial part of this range of problems, and more countries in the sub-region clearly need to introduce this feature. But it needs to be stressed that the problem of bureaucratic delay is far wider. Unless further steps are taken to cope with the myriad of complaints foreign investors make in this area, this impediment will remain a significant deterrent to future investment flows.

IV.3.5 Country size and regional markets

The disadvantage of smallness for attracting foreign investors cannot be over-stressed: restricted purchasing power associated with the small size of the market in many African countries has proved a serious impediment both to investors whose output has been exclusively for the domestic market and to those who have required a strong domestic market as a base for export-oriented production. But the problem goes much further than the obvious ones of a smaller market, offering fewer profitable opportunities because of economies of scale. The absolute level of profits will be small, and in the context of a firm with limited managerial resources, the costs of gaining information (which will be little different from those for a larger country) may deter investment in most sub-Saharan countries.

As a result of these problems, economic integration is widely seen as being one of the key factors to progress and one on whose success foreign investment inflow is expected to be boosted. Yet in spite of renewed talk of regional integration in the 1980s, the reality is that the hope of substantial change must realistically remain distant. The institutional arrangements underlying closer integration - from the UDEAC to the Preferential Trade Area of Eastern and Southern Africa (PTA) - are frail and under-financed. In particular the classical problem of generating benefits to economically weaker states from economic association are demonstrably unsolved.

In West Africa, in particular, the picture remains bleak. The two Francophone customs unions remain in existence and of course continue to operate a common exchange rate with all other currencies. Trade with the Anglophone countries of the region is brisk but informal and largely illegal. The Economic Community of West African states (ECOWAS) has attempted to operate a currency clearing system through the West African Clearing House (WACH), but this has been unable to finance the deficits of those countries with a continual trade imbalance - at least officially - with the group as a whole. Further, the member states continue to pursue competitive incentive regimes towards FDI, even though this is explicitly ruled out by Articles 28-32 of the ECOWAS charter.

In the east and south, the creation of the Southern African Development Co-ordination Conference (SADCC) and the Preferential Trade Agreement (PTA) of Eastern and Southern Africa provide some encouragement. Already the creation of SADCC would appear to have stimulated some foreign investment, on a joint venture basis, to exploit the new opportunities presented by these developments. Problems,

however, remain, not the least of which is the shortage of trade finance and export credits without which regional trade is likely to remain at its current low level.

It could be argued that it is inappropriate to attribute the stagnation in FDI in the 1980s to the small size of domestic markets since these markets were probably even smaller in the 1970s, at least if measured in relation to population size. The rise in investment during this period (see Figures 4 and 5, above) was very modest (less than \$4 billion from 1975 to 1982), at a time when Latin American countries (for the most part with much larger markets) saw an increase of nearly \$50 billion.⁵⁷ What is more, uncertainty, if not pessimism, about the development of regional markets was also prevalent in the 1970s,⁵⁸ and together with the various nationalisation strategies adopted in that decade certainly contributed to Africa's relative lack of attraction as an home for investment even at that time.

IV.3.6 Providing matching finance

We return finally to the issue of financing investment, and shall consider first offshore, and then local finance.

(1) Offshore finance

Trends in new forms of investment for external investors in Africa have important implications for the financing of projects. If outside "investors" will bring in only token quantities of equity finance, this means that - in order to avoid unacceptable gearing ratios - increasing quantities must be raised on domestic capital markets. It also means that the aggregate level of investment will be assisted if external development finance institutions (DFIs) can increase the proportion of their project finance made available as equity. Those DFIs which are based in the EC - such as the Commonwealth Development Corporation and the

⁵⁷ The rise was from \$21 billion in 1975 to \$68 billion in 1982. See Dunning and Cantwell (1987).

⁵⁸ The East African Community was formally wound up in 1978.

Caisse Centrale de Co-operation Economique⁵⁹ - have a total stock of investments comprising both loans and equity of about ECU 4.5 bn. Yet the equity component accounts for only about 4% (or ECU 165 mn) of the total. These funds are mainly co-invested with private sector companies from the EC, and with investors in the host country (which have frequently been parastatal organisations). The DFIs are often associated with projects in which the external private sector investor has a strong interest in the type and structure of the "NFI".

The existence and prominence of these agencies provides an opportunity for them to play a major role as "facilitator", in improving the investment climate for both existing and potential private sector investors. Given investors' growing preference for NFI, there is an acute need to avoid very high and therefore unfavourable, loan-to-equity ratios by increasing the volume of equity-type finance from "third party" sources, such as these DFIs and, of course, the IFC. This need not be restricted to formal share capital, but should increasingly extend to forms of "near-equity", such as preference shares, and to the underwriting of share and bond issues on African financial markets.

In other ways, too, it is desirable for the DFIs to "liberalise" their lending conditions if their activities are to continue to expand. In many cases, their support for a project is conditional on a government guarantee of the repayment of loan principal and of interest payments; sometimes there is a demand - which is favoured, for instance, by the IFC - that a supplier of NFI should have a minimum equity stake of about 25% of the equity capital; sometimes there is an insistence that "concessions" granted to one equity holder should be granted to all. A by-product of the search for a guarantee is that where the loan is made to a local finance house, the exchange risk is frequently passed on to the final borrowers. In the 1980s - with the wide experience of currency devaluation - this has, in many instances, been disastrous for the cash flow of the target project. Alternative approaches to dealing with the difficult problem of local currency depreciation include allowing the final borrower to select between a high interest rate with no exchange risk, and a lower interest rate with the exchange risk.

⁵⁹ Others would include the Deutsche Entwicklungsgesellschaft [DEG], Société Belge d'Investissement [SBI], "Industrial Fund for Developing Countries" [IFU], "Finance Corporation for Developing Countries"[FCO], and the European Investment Bank [EIB].

Without these kinds of options, the ability of the DFIs to participate in financial packages in support of FDI may be severely limited. In fact, the decline in the number of projects financed by the IFC from 1988 to 1989 (highlighted above) partly reflects these problems.

(ii) Local finance

Many potential projects funded by DFIs face a problem in raising local currency finance to match offshore loan and equity capital. For the European Investment Bank's projects in the African Caribbean and Pacific (ACP) group (in which Africa is the most dominant) from 1976-85, more than half the total finance had to be raised outside the host country (see Githongo, 1988).

Lack of access to domestic capital markets is most frequently encountered through restrictions placed on borrowing locally. Foreign companies may also be prevented from buying into local companies. This is particularly serious for companies which are also prevented from remitting abroad all their profit and dividend payments.⁶⁰ Countries may also restrict foreign ownership of land, or entry into particular sectors. Those where the extent and nature of restrictions are uncertain or changeable, such as Zambia, are likely to be particularly discouraging for investors.

Current evidence suggests that the relative shortage of domestic capital for lending or investing long term is seldom due to the low level of time and savings deposits, but much more often to the relative profitability to the banks and other financial institutions of lending short term. In fact, time and savings deposits as a proportion of total deposits in Nigeria grew from 30% to 60% from 1960-88. In Zambia in 1988 these categories of deposit accounted for 50% of all savings, and in Kenya for 65%. This fairly high proportion of long-term saving is not just due to the move to positive real interest rates which has been engineered as part of structural adjustment in the 1980s. In Kenya, quantitative estimates suggest an interest rate elasticity of 0.6. In Nigeria, "it is quite possible that

⁶⁰ The Chairman of RTZ in Zimbabwe publicly drew attention to this problem in May 1988.

saving is relatively interest-inelastic and that other factors - such as distance from and waiting time in banks - may be more powerful influences on saving".⁶¹

Central Banks have endeavoured to respond to the problem of shortage of local capital for investment projects by laying down guidelines on the volume of banks' loan portfolio which should be long-term. In the case of Nigeria, the target figure in 1988 was 50%, but the actual level was only 30%. However, the crucial shortage is frequently in the field of risk capital and specifically of equity. The mobilisation of such capital is not dependent on the existence of a stock exchange but could equally well be achieved by the launch of local investment trusts, shares in which could be taken by existing local financial intermediaries such as insurance companies, pension funds and even local "grass roots" savings groups, which frequently find it difficult to re-invest their deposits. Such trusts might also seek to attract capital flight from domestic sources. Given the continuing attraction to the banks of lending short term, there is a strong case for the development of this innovatory instrument, or for the activation of stock exchanges.

Without initiatives of this nature, the task of mobilising local financial resources to match offshore investment are likely to prove elusive.

IV.4 A More Active Approach to Investment Promotion

The proposals for change just outlined are grounded in the view that there is a positive relationship between the removal of various impediments and a rise in the inflow of foreign investment. This, in turn, is based on two key assumptions. The first is perfect or near-perfect knowledge of investment opportunities in SSA. It is assumed that potential investors are aware of the opportunities in Africa and that once sufficient identifiable restrictions are removed investment will flow. The second assumption is that there is a known and tangible group or list, of "potential investors" interested in investing in the SSA region to whom this near-perfect knowledge is available.⁶²

⁶¹ This quotation, and the statistics quoted here, are all taken from Githongo et al (1988).

⁶² We have already suggested that events and attitudes outside the SSA region provide few grounds for believing that significant increases in foreign investment inflows would follow the continued removal of impediments in particular

These assumptions tend to lead to the dominance of what can be termed the passive approach to the promotion of foreign investment. The passive approach is based on the view that it is broadly sufficient to devise a package of incentives (hopefully longer and better than one's neighbours'), to list the areas of the economy or sub-sectors where foreign investment would be welcome, and then sit back and wait in hope that the new investment will be forthcoming. Not infrequently, host governments also provide a "shopping list" or register of often scores of projects in which they would like foreign participation.⁶³ One reason why this passive approach to foreign investment appears to be so influential in SSA is that many governments are unclear precisely which areas of the economy they would like to see developed, by whom and in which order of priority. It would also appear that the international institutions, or at least consultants employed by them, have encouraged governments to adopt the passive approach.⁶⁴

In contrast, an active approach to foreign investment is characterised by governments going out and approaching specifically-targeted foreign investors, with a view to their investing in the development of a product they produce in the home or another country, or at least in a particular sub-sector. This more aggressive approach is likely to be most effective to the extent that the host government has decided upon its future investment portfolio in some detail, and has a view, too, on the areas in which it believes local investors will become involved and those areas where it is convinced that it needs foreign finance, technology, know-how, machinery and/or marketing skills and/or contacts.

Equipped with a list of potential projects it wants to be executed by foreigners (in whole or in part), the next step - in the active approach - is for the host government to do three things:

countries.

⁶³ Not infrequently, too, this list is cobbled together hurriedly, and with little enthusiasm, by civil servants at the request of ministers who have been persuaded by well-meaning donors to host an international investment conference.

⁶⁴ This itself is probable influenced by the fact that the advisors from these institutions tend predominantly to be economists, for whom market theory and market forces are of major importance, rather than hardened investors, among whose prominent tools of trade have been negotiation and bargaining processes and techniques.

- (i) go and seek out those companies which are able to provide the identified missing components;⁶⁵
- (ii) invite them to examine the details of the proposed project areas or products for which foreign participation is sought; and, finally,
- (iii) propose that they put forward the conditions under which they would consider participating.

They would of course be made aware that other (rival) companies in the same field were also being approached. Then begins the process of bargaining and negotiation which, hopefully, will lead to firm investment proposals from one company being accepted by the host government.

This active approach to attempting to obtain foreign investment should not be seen as an alternative to the passive approach, but rather as complementary to it. General guidelines, the overall macro-economic environment, and the streamlining of the decision-making process are all necessary components of a total investment strategy. They remain, however, by no means sufficient conditions. Nor - one needs to hasten to add - is it being suggested here that a combined active and passive approach is sufficient either. Rather, this combined approach adds a major - and different (active) - component to the package which is prevalent through most of the SSA region.

The active approach is not based on the assumption that potential investors have perfect knowledge of opportunities in far-off places, or on the assumption that "potential" investors in Africa know that they are potential investors. Rather it is based on widely-held view that a direct approach may often be the catalyst required for a company to begin to think about SSA as a field for investment. This direct approach is likely to be of greater importance the smaller the host country, the less it is in the international news media, and if press comment commonly portrays the country in a poor light.⁶⁶

⁶⁵ In some circumstances this could be companies from the industrial countries at the frontier edge of technological development, in others southern TNCs could be more appropriate.

⁶⁶ The opposite extreme can be illustrated by the case of Mexico where, within weeks of the announcement of new regulations for foreign investment in May 1989, some 40 foreign investment applications for projects with an estimated \$900 mn had arrived at and were under study by Mexico's National Foreign Investment Commission (CNIE) (Financial Times, 25 May, 1989).

International or industrial country investment missions are not without their merits. Indeed, and especially, investment missions from particular industrial countries with expertise of investment projects in the countries to be visited can often provide an influential stimulus to investment. Such initiatives should, therefore, also be seen as part of the overall/complementary approach to investment promotion. A recent example of this would be the US OPIC mission of potential US investors to southern Africa in April 1989.⁶⁷ This led, for instance, to a joint venture agreement with the Houston-based Interkiln for the manufacture and export of roofing tiles, bricks and other clay products from Botswana.

A major factor in favour of the wider applicability of the active approach to foreign investment is the successes that the, albeit limited, number of countries of SSA have had in attracting foreign investors on the basis of a more positive and aggressive selling of particular opportunities. We can end with a few examples.

- The textile plant privatisation in Togo was concluded in February 1987 only after the government had considered eleven competitive bids from foreign investors as far afield as India, Western Europe and the United States.
- Bridge Oil of Australia became involved in Guinea following an approach by the Guinean government to a Swiss banker in 1981 looking for a joint venture partner. The Swiss banker was a friend of the chairman of Bridge Oil. As a result Bridge Oil did a feasibility study and "the more it looked at the prospect, the more it felt it should be involved" (Financial Times 9 November, 1988).
- Botswana has declared Selibe Phikwe a special investment zone where a 20-year tax holiday is open to companies willing to invest. In 1990, the government is sending out special missions to East Asia to sell the idea, targeting in particular textile manufacturers, with the additional carrot of preferential terms of entry to the EC under the

⁶⁷ The success of this particular trip was in part attributable to the identification of particular projects by Equator Bank.

Lomé Convention. One mission is going to Hong Kong, targeting companies considering up-rooting from the colony.

V. CONCLUSIONS

Foreign investment will be required in SSA increasingly in the 1990s to help raise the supply of foreign exchange and to boost investment levels. Continued high foreign debt repayments, poor prospects for primary commodity prices in at least the first half of the 1990s for most countries in SSA, and lower than required inflows of official development assistance all mean that the foreign exchange gap which widened in the 1980s is set to continue to restrain economic growth in the 1990s. This, together with other macro-economic influences, will in turn tend to dampen prospects for raising domestic savings levels, crucially necessary for boosting the sub-region's dangerously low levels of domestic investment. Both the foreign exchange gap and the savings gap could be filled, at least in part, by increased flows of foreign investment.

Foreign investment inflow will occur in the 1990s (as it did in the 1980s) largely in relation to opportunities in a number of key sectors, such as energy, and certain minerals, but additionally in relation to selected export manufacturing opportunities - largely a new phenomenon. These new manufacturing opportunities are likely to develop in relation to gaining privileged access to large markets outside the African continent, as well, perhaps, as in the tourist industry. These and all other opportunities should be taken and exploited, at least in part by extending a more aggressive and project-specific marketing technique to attractive potential investors. The least attractive areas for the foreign investor in Africa in the 1990s are likely to be in exclusively import-substituting industrialisation.

There is, however, no realistic prospect whatsoever for flows of foreign investment to be adequate to bridge either the foreign exchange or domestic savings gaps. Indeed there are grounds for suggesting that in spite of the extension of policies more liberal to foreign investment inflow - which are certainly being put in place in most countries of SSA - the prospects for foreign investment inflow in the 1990s may well be worse than they were in the dismal years of the 1980s. In part this conclusion is based on external factors - prospects in other parts of the rapidly changing world look brighter and less risky and are closer to home.

In part, too, the conclusion is based on the history of the 1980s. Foreign investment prospects are in some way bound up in a Catch-22 scenario. Potential investors are unlikely to commit large amounts of money to the SSA region unless

and until the prospects for growth improve. But, given the other constraints on development, these are likely themselves to be influenced by the success of countries in attracting greater amounts of both public and private foreign capital.

BIBLIOGRAPHY

- Baker, P. H. (1983) Obstacles To Private Sector Activities in Africa, Washington DC: Batelle Memorial Institute, January.
- Bennell, P. (1990) "British Industrial Investment in sub-Saharan Africa: Corporate Responses to Economic Crisis in the 1980s" Development Policy Review, Vol. 8, No. 2.
- Cable, V. and Persaud, B. (Eds) (1987) Developing with Foreign Investment, London: Croom Helm and the Commonwealth Secretariat.
- Campbell, B. (1983) "Etat et Developpement du Capitalisme en Côte d'Ivoire" in Enterprises et Entrepreneurs en Afrique: XIXe et Xxe Siecles, Paris.
- Chang, P.H.K. and Cumby, R.E. (1990) "Capital Flight in Sub-Saharan African Countries", New York: Stern School of Business, New York University (mimeo).
- Cockcroft, L. (1989) "The Past Record and Future Potential of Foreign Investment", paper presented to Queen Elizabeth House and Overseas Development Institute Workshop on "Alternative Development Strategies in Africa", Oxford, December.
- Cockcroft, L. (1990) Africa's Way: A Journey from the Past, London: I.B. Tauris.
- Coughlin, P. (1990) "Kenya: Moving to the next phase?" in Riddell *et al* (1990c).
- Davenport, M. and Page S. "The Effects of 1992 on the Developing Countries", London: Overseas Development Institute, August.
- Dunning, J.H. and Cantwell, J.A. (1987) The directory of Statistics of International Investment and Production, London: Macmillan.
- Ffrench-Davies, R. (1987) "A view from the developing countries" The CTC Reporter, 23 (Spring).
- Githongo, J.M. *et al.* (1988) Investment in the ACP States and Related Financial Flows, report (two-volume) by a group of EEC and ACP experts, Brussels, Nairobi and Nice.
- Gershenberg, I. (1983) Multinational enterprises, the transfer of managerial know-how, technology choice and employment effects: a case study of Kenya, Working Paper No. 28, Multinational Enterprises Programme, Geneva: International Labour Office.
- Grosh, B. (1990) "Public, Quasi-Public and Private Manufacturing Firms in Kenya: the Surprising Case of a Cliché Gone Astray" Development Policy Review, Vol. 8, No. 1, March.
- Guisinger, S. (1986) "Host-Country Policies to Attract and Control Foreign Investment" in Moran *et al.*

Harrison, P. and Palmer, R. (1986) New South Africa: Biafra to BandAid. London: Shipman.

International Finance Corporation (IFC) Annual Report 1989. Annual Report 1990, Washington: IFC.

International Monetary Fund (IMF) (1989) International Financial Statistics Yearbook 1989, Washington: IMF.

Japan External Trade Organisation (JETRO) (1989) Nippon: Business Facts and Figures, Tokyo: JETRO.

Kim, C.H. (1985) The Concept and Social Position of the "Managerial Elite" in Contemporary Kenya with special reference to Africanisation, Working Paper No. 431, Institute of Development Studies, University of Nairobi.

King, K. (1977) The African Artisan, Nairobi: Heinemann.

Lamusse, R. (1989) Adjustment to Structural Change in Manufacturing in a North-South Perspective: the case of the clothing export sector in Mauritius, Geneva: International Labour Office.

Lewis, S. R. (1987) Economic Realities in southern Africa, Discussion Paper No. 232, Brighton: Institute of Development Studies.

Lipton, M. (1988) Sanctions and South Africa: the dynamics of economic isolation Special Report No. 1119, London: Economist Intelligence Unit Ltd.

Lütkenhorst, W. (1988) "Challenges from New Trends in Foreign Direct Investment" InterEconomics, September/October.

Manzini J. *et al.* (1979) Multinationals and Development in Black Africa: A Case study of the Ivory Coast, Farnborough: Saxon House in association with the European Centre for Study and Information of Multinational Corporations.

Ministère de l'Industrie (Côte d'Ivoire) (1988) Schéma Directeur de Développement Industriel de La Côte d'Ivoire, Abidjan: Ministère de L'Industrie.

Moran, T. H. (1985) Multinational Corporations: The Political Economy of Foreign direct Investment, Lexington: Lexington Books.

Moran T. H. *et al.* (1986) Investing in Development: New Roles for Private Capital, US-Third World Policy Perspectives No. 6, Washington: Overseas Development Council.

Nzomo, D. (1971) Occupational Kenyanisation in the Private Sector, Staff Paper No. 108, Nairobi: Institute of Development Studies.

Nsouli, S.M. (1989) "Structural Adjustment in sub-Saharan Africa" Finance and Development, Vol. 26, September.

Ohiorhenuan, J.E. and Poloamina, I.D. (1989) "Indigenous Technological Capacity in African Industry: the Nigerian Case", Ibaen (mimeo).

- Oman, C. (1984) The New Forms of International Investment in Developing countries, Paris: OECD.
- Oman, C. (1989) New Forms of Investment in the Metals, Petrochemicals, Automotive, Textiles and Food Industries in Developing Countries, Paris: OECD.
- Onimode, B., Ohiorhenuan, T. and Adeniran, T. (1983) Multinational Corporations in Nigeria, Ibaden: Skyraden.
- Organisation for Economic Cooperation and Development (OECD) (1989) Financing and External Debt of Developing Countries, Paris: OECD.
- Page, S. B. and Riddell, R. C. (1988) "Opportunities For an Impediments to Foreign Direct Investment in Africa", report prepared for the United Nations Centre for Transnational Corporations, London: Overseas Development Institute (mimeo), published in part "FDI in Africa: Opportunities and Impediments", The CTC Reporter, No. 27, Spring 1989.
- Parhizgari, A.M. (1988) "Debt Swaps: Innovative Proposals" Economic Impact, Vol. 2.
- Riddell, R.C. (1984) "Zimbabwe's Experience of Foreign Investment Policy", paper prepared for the Commonwealth Fund for Technical Cooperation of the Commonwealth Secretariat, reproduced (in abridged form) in Cable and Persaud (1987).
- Riddell, R.C. (1988) "New Sanctions against South Africa" Development Policy Review, Vol. 6, No. 3, September.
- Riddell, R. C. (1990a) "Côte d'Ivoire", in Riddell *et al.* (1990c).
- Riddell, R.C. (1990b) ACP Export Diversification: The Case of Zimbabwe, Working Paper No. 38, London: Overseas Development Institute.
- Riddell, R. C. and Associates (1990c) Manufacturing Africa: Performance and Prospects of Seven Countries in sub-Saharan Africa, London and New York: James Currey and Heinemann.
- Saasa, O. S. (1987) Zambia's Policies Towards Foreign Investment, Research Report No. 79, Uppsala: Scandinavian Institute of African Studies.
- Segal, S.L. (1987) "Debt-Equity Swaps: a banker's view" The CTC Reporter, 23 (Spring).
- United Nations (1988) "Critical Economic Situation in Africa: UN Programme of Action for African Economic Recovery and Development 1986-1990" Midterm review of the implementation of the United Nations Programme of Action for African Economic Recovery and Development 1986-1990, Report of the Secretary General Addendum: Investment of transnational corporations in Africa, New York UN General Assembly, A/43/500/Add.2, 15 August.

United States Department of Commerce (1986) Direct Investment Update: Trends in International direct Investment, Washington: International Trade Administration, US Department of Commerce.

World Bank (1989a) World Tables 1989, Washington: The World Bank.

World Bank (1989b) Sub-Saharan Africa: From Crisis to Sustainable Growth, Washington: The World Bank.

World Bank (1989c) Trends in Developing Economies 1989, Washington: The World Bank.

World Bank (1989d) Zimbabwe: Private Investment and Government Policy, Washington: The World Bank.

PFE Working Paper Series

	<u>Title</u>	<u>Author</u>	<u>Date</u>	<u>Contact for paper</u>
WPS596	The Mexican Sugar Industry: Problems and Prospects	Brent Borrell	February 1991	P Kokila 33716
WPS597	Rent Sharing in the Multi-Fibre Arrangement: Theory and Evidence from U.S. Apparel Imports from Hong Kong	Refik Erzan Kala Krishna Ling Hui Tan	February 1991	G. Ilogon 33732
WPS598	Africa Region Population Projections: 1990-91 Edition	Patience W. Stephens Eduard Bos My T. Vu Rodolfo A. Bulatao	February 1991	O. Nadora 31091
WPS599	Asia Region Population Projections: 1990-91 Edition	Eduard Bos Patience W. Stephens My T. Vu Rodolfo A. Bulatao	February 1991	O. Nadora 31091
WPS600	Latin America and the Caribbean Region Population Projections: 1990-91 Edition	My T. Vu Eduard Bos Patience W. Stephens Rodolfo A. Bulatao	February 1991	O. Nadora 31091
WPS601	Europe, Middle East, and North Africa Region Population Projections: 1990-91 Edition	Eduard Bos Patience W. Stephens My T. Vu Rodolfo A. Bulatao	February 1991	O. Nadora 31091
WPS602	Firm Output Adjustment to Trade Liberalization: Theory with Application to the Moroccan Experience	Mark A. Dutz	February 1991	S. Fallon 38009
WPS603	The Role of Officially Supported Export Credits in Sub-Saharan Africa's External Financing	Aslı Demirgüç-Kunt Refik Erzan	February 1991	G. Ilogon 33732
WPS604	Foreign Trade and Its Relation to Competition and Productivity in Turkish Industry	Faezeh Foroutan	February 1991	S. Fallon 37942
WPS605	Overview of Contractual Savings Savings Institutions	Dimitri Vittas Michael Skully	March 1991	W. Pitayato- nakarn 37666
WPS606	Adjustment Policies and Investment Performance in Developing Countries: Theory, Country Experiences, and Policy Implications	Luis Servén Andrés Solimano	March 1991	E. Khine 39361

PRE Working Paper Series

<u>Title</u>	<u>Author</u>	<u>Date</u>	<u>Contact for paper</u>
WPS607 Abolishing Green Rates: The Effects on Cereals, Sugar, and Oilseeds in West Germany	Donald F. Larson Simon, Glance Brent Borrell Merinda Ingco Jonathan Coleman	March 1991	D. Gustafson 33714
WPS608 Cross-Country Studies of Growth and Policy: Methodological, Conceptual, and Statistical Problems	Ross Levine David Renelt	March 1991	CECMG 39175
WPS609 A Sensitivity Analysis of Cross-Country Growth Regressions	Ross Levine David Renelt	March 1991	CECMG 39175
WPS610 Can Preshipment Inspection Offset Noncompetitive Pricing of Developing Countries' Imports? The Evidence from Madagascar	Alexander J. Yeats	March 1991	J. Jacobson 33710
WPS611 Tariff-based Commodity Price Stabilization Schemes in Venezuela	Jonathan R. Coleman Donald F. Larson	March 1991	S. Lipscomb 33718
WPS612 Education and Productivity in Developing Countries: An Aggregate Production Function Approach	Lawrence J. Lau Dean T. Jamison Frederic F. Louat	March 1991	WDR Office 31393
WPS613 Price-Wage Dynamics and the Transmission of Inflation in Socialist Economies: Empirical Models for Hungary and Poland	Simon Commander Fabrizio Coricelli	March 1991	O. Del Cid 39050
WPS614 Accountability in Public Services: Exit, Voice, and Capture	Samuel Paul	March 1991	E. Madrona 37496
WPS615 Socialist Economic Growth and Political Investment Cycles	Heng-fu Zou	March 1991	A. Bhalla 37699
WPS616 Optimal Nonlinear Income Taxation for the Alleviation of Poverty	Ravi Kanbur Michael Keen Matti Tuomala	March 1991	J. Sweeney 31021
WPS617 International Poverty Projections	Sudhir Anand Ravi Kanbur	March 1991	J. Sweeney 31021
WPS618 Poverty and Development: The <i>Human Development Report</i> and the <i>World Development Report</i> , 1990	Ravi Kanbur	March 1991	J. Sweeney 31021
WPS619 Foreign Direct Investment in Sub-Saharan Africa	Laurence Cockcroft Roger C. Riddell	March 1991	S. King-Watson 33730