Foreign Direct Investment Into African Nations (1970-2000)

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Abstract

The paper surveys the inflow of foreign direct investment into 10 African countries in the period 1970 to 2000. The countries were selected to reflect differences in size and economic development as well as to reflect all the regions of the continent. It was found that, on a per capita basis, there was a higher inflow of foreign direct investment into those countries that allow greater relative economic freedom and those that have a legal environment that protects property rights. It is suggested that in order to attract greater inflows of foreign direct investment in the future, African nations need to accelerate progress towards more open economies, greater economic freedom and a legal environment that guarantees property rights.

Introduction

Many factors account for the painfully slow pace of economic development in most African countries. The list is long, but we can just name three: the continent is saddled with a crippling foreign debt which stood at $350 billion in 2000 (World Bank 2000) with no sign of imminent relief; inadequate health delivery systems in many nations are now overburdened with the frightening scourge of Aids epidemic; finally, wars and other forms of civil strife continue to rage in various parts of the continent: Somalia, Sudan, Sierra Leone. In the circumstances, it is difficult for one to be very optimistic about rapid economic development in many of the continent's member nations. Indeed, "the basic ingredients for such a transformation are not present at the moment" (Obasanjo 2001). Nevertheless, this paper will attempt to explore prospects for improving one of such ingredients, namely, the ability of African countries to attract foreign direct investment (FDI).

FDI and Economic Development

The literature on development studies documents many factors that enable nations to attain rapid economic development. The enabling role of large and sustained levels of domestic savings, for instance, was stresses by Alwyn Young (1995) who showed how a policy of 'forced savings' enabled South Korea to raise her investment-GDP ratio from 5% in 1950 to over 30% in 1980 as the national economy grew rapidly. The same direct link between savings, investment and economic development was emphasized recently in a study by the Federal Reserve Bank of St. Louis (1998).

Foreign Direct Investment has been cited as a very important stimulus for rapid economic development. One of such studies detailed the direct link between FDI and the development of the

‘Asian Tigers’ – Singapore, Taiwan, Hong Kong and South Korea – over two decades (Amirahmadi Wu 1994). Summary and Summary (1994) showed that FDI played a complimentary role to US direct government aid in stimulating the economic transformation of some developing nations. In other studies, the specific role of FDI in manufacturing in spurring the rapid economic development of other Asian countries was established (Bajo-Rabio and Sosvilla-Rivero 1994, Nguyen and Cosset 1995, De Mello Jr. 1997). The conventional wisdom, in fact, is that “capital inflows allow a country to achieve higher rates of growth” (Hill 2001). Even Japan, which for many years restricted FDI inflows, has now started to effect reforms to redress the situation although her inflows at $24.2 billions in 1998 remains small compared to other advanced economies--$193.4 for the US and $63.1 billions for the UK in the same year. (Eun and Resnick 2001).

FDI inflows into the economies of the world stood at $865 billion in 1998 and were said to be close to $1 trillion in 2000 (UNCTAD 2001). Of this, the entire African continent accounts for only $9 billion – less than 1%. It is not surprising that little attention has been paid to the issue of FDI in the continent. And yet the continent’s need for inflows of FDI to stimulate economic growth is enormous. It is hoped this modest review might stimulate further interest and research on this important subject.

Recent Trends in FDI Inflows:

Growth in the flow of FDI in the world economy has been phenomenal. At an average annual growth rate of $25 billion since 1975, the total stock of global FDI stood at over $4 trillion by 1998. Inflows of most FDI have historically been directed to the world’s advanced economies. Thus FDI inflows into the world’s developed economies grew at an average annual rate of $27 billion accounting for over 17% of the total by 1998 and 1999. The growth rate of the annual flow of FDI into the economies of developing nations was even more remarkable. At $149 billion in 1997, FDI flow into the worlds developing economies accounted for over 37% of the world total. (See Table 1)

Table 1: FDI Flows Into the World Economy 1995-1999 ($ Billion)

	1995	1996	1997	1998	1999
Into Advanced					
Economies	207.9	212.4	253.7	480.6	636.5
Into Developing					
Nations	129.3	137.2	149.0	179.0	208.0
World Total	337.2	349.6	402.7	659.6	844.5

Source: UNCTAD, World Investment Report 2000, table 1.1 p2

Inflow of FDI Into Developing Economies:

As has been indicated, the inflow of FDI into developing nations has soared in recent years. Historically, however, not a single African country ranks among the top ten recipients of FDI flowing into the developing world. That distinction appears to have been ‘reserved’ for Brazil and Mexico in

South America and for Asian nations with China featuring prominently after 1990. During the decade of the 1980's, for instance, Brazil's share started from a peak of 17% in 1980 declining to a still very significant share of 9% of all FDI flows into the same group of nations by 1999. During the same period, Mexico accounted for between an 8% and 12% share of all FDI flowing into developing economies other major recipients of FDI among developing nations are: Singapore whose annual share was steady at 11%; Malaysia whose share declined from 9.3% in 1980 to 4.1% by 1990; Thailand which recorded a modest increase from 2.4% in 1980 to 4.7% in 1990; and China whose share ballooned from 4.4% in 1980 to 11.3% in 1990.

In the decade of the '90s, China emerged as the single most important recipient of FDI among developing nations. By 1992, China attracted over $5 billion worth of FDI or more than 14% of the total for developing nations. China's share has climbed steadily ever since and by 1995, inflows of FDI accounted for nearly 26% of the fixed capital formation of the country. Mexico's share of FDI inflow was quite high at $4.34 billion in 1991 or 12.6% of the developing nations' total. Evidently helped by the coming into effect of the NAFTA agreement, Mexico has continued to maintain a strong position with FDI inflow accounting for some 17.1% of the country's fixed capital formation by 1995. The other recipients among developing nations were respectively 9.6%, 6.8%, and 5.6% by 1995. Venezuela, Brazil, Indonesia, South Korea and Turkey round up the list of top Ten FDI recipients in the developing world. They respectively attracted $1.9 billion, $1.6 billion, $1.5 billion, $1.1 billion and $0.8 billions worth of FDI in 1995. Their shares of developing nations total were also 5.3%, 4.5%, 4.1%, 3.1%, and 2.3% respectively. Cumulative FDI inflows into the top six developing nations between 1985 and 1995 are summarized in Table 2 below. The per capita column clearly shows the remarkable achievement of the relatively small nation of Hong Kong (now a Chinese province) in steadily attracting more FDI than most other developing nations.

Table 2: Leading FDI Recipients Among Developing Nations 1985-1995

Country	Cumulative FDI Inflow ($ Billions)	FDI Inflow per capita ($)
China	130.2	110
Mexico	44.1	470
Malaysia	30.7	1520
Argentina	20.3	680
Brazil	20.3	130
Hong Kong	17.0	2890

Source: Extracted from various annual trade and investment releases of UNCTAD and the UNDP.

Factors Determining FDI Flows

It has been suggested that the world's advanced economies and those developing nations, which have been very successful in attracting relatively large inflows of FDI, possess some fundamental

enabling conditions. The first obvious condition is that these countries have established stability in their national political and economic arrangements (Kobrin 1979). Another is a strong commitment to investment in education, which has enabled the countries to produce, in large numbers, the diverse, and high quality skills they need. This is the explanation given for the success of nations like South Korea And Hong Kong, for instance, in attracting large inflows of FDI (Economist, September 1996) in the 1970's and 1980's. Others have cited the importance of domestic savings, which form the basis for strong local investment in infrastructure, and local manufacturing which in turn can induce even larger foreign capital inflows (de Mello 1997).

By far, the most important set of factors concern economic openness, political stability and a legal structure that protects property rights (Hill 2001). Economic openness is relatively easy to measure. One way of doing this is to examine the extent to which trade is unrestricted in a given economy. Liberal trade measures will be reflected in an increasing and unimpeded level of annual importation of goods and services. Expressed as percentages of GDP, annual import statistics become a reasonable basis for making comparisons between nations on the issue of economic openness. The other factors do present problems of objectivity and interpretation. Nevertheless, some rankings are now available from several organizations. Random House, for instance, publishes annual 'indices of freedom' for nations of the world. These freedom ratings range from 1 (for the freest) to 7 (for the lowest degree of political freedom): they are based on factors that include the free formation of political parties, the holding of periodic free and fair elections and the absence of domination by the military or foreign powers (Freedom House 1997). Heritage Foundation attempts to measure a combination of economic and political freedom issues in their annual 'Index of Economic Freedom' for all countries in the world. Their scores range from 1, for the freest economies, to 5 for the most repressed. They use objective economic data, such as inflation rate, which some economist (Bajo-Rabio and Soscvilla-Rivero 1994) accept as a proxy for macroeconomic stability needed to induce capital inflows. They also include some political assessments based on the judgment of the researchers (Heritage Foundation 2001). Some would argue that these organizations have a conservative bias, but the bias, if present, will be common to all countries and a valid comparison between nations can still be made using the indices. Hence we have decided to use them in this analysis.

The issue of the legal environment is important because it defines the scope of protection for property rights and the safety of investment, both of which are crucial to the inflow of FDI. Even in the advanced economies of Europe, it has been observed that dissimilar legal structures lead to dissimilar financial arrangements and capital inflows (Cecchetti 1999). Similarly, it has been shown that the legal structure of an economy determines, in part, the extent to which external funds flow into that economy (La Porta, Lopez-de-Slanes, Schkeifer and Vishny 1997 and 1998). They contend that an enabling legal environment, for instance, must be present before investors are wiling to surrender their funds in exchange for securities or other ownership instruments. The

conclusion is that the issues of economic openness, economic and political freedom and legal structure are important determinants of the rate at which FDI flows into an economy.

The rest of this paper will focus on the se issues as they relate to African countries. We shall examine Africa's trade and FDI statistics along with economic openness, economic and political freedom, and legal framework to see the extent to which they explain the continent's inability to attract large volumes of FDI. We shall compare the FDI trends between African nations themselves and see if they provide some clue for future improvement. We have selected countries on which ample data is available and which reflect the diversity of the continent. The list thus includes relatively large countries in the north (Egypt and Algeria), west (Nigeria and Ivory Coast), east (Kenya), and south (South Africa). In fact, Egypt, Nigeria, and South Africa accounted for better than 85% of the continent's FDI inflow in 1999. The list also includes small nations, such as, Botswana and Mauritius for which the needed statistics were available.

FDI Inflows into Africa

We have already noted that the continent's shear of global FDI inflows is negligible. Out of the ten African countries selected for this analysis, only two (Egypt $1.5 billion; Nigeria $1.3 billion) recorded FDI inflows of more than $1 billion by 1999. South Africa, following the end of apartheid, had a relatively impressive showing reaching a peak of $3.8 billion in 1997. But there has been a sharp and steady decline since then. Some countries, actually witnesses a decline in their FDI inflow over the decades 1970-1999. Thus, Ghana started out with $68 million in 1970 but could only attract $45 million by 1999. Algeria attracted no FDI at all between 1985 and 1994. It is doubtful that her FDI level of $250 million in 1999 will hold in the years to come. The FDI inflows for ten selected African countries for the period 1971-1999 is summarized in Table 3.

Table 3: FDI Flows Into Selected African Countries 1970 – 1999 (1995 US $Millions)

Country 1970	1975	1980	1990	1995	1996	1997	1998	1999		
Algeria	47	119	349	0	5	4	7	5	250	
Botswana	0	38	112	95	70	71	100	95	109	
Ivory Coast	31	69	95	48	212	269	341	435	252	
Egypt	0	8	548	734	598	636	691	1076	1453	
Ghana	68	71	16	15	107	120	83	56	45	
Kenya	14	17	79	57	32	13	20	11	12	
Mauritius	2	4	1	41	19	37	55	12	10	
Nigeria	205	418	740	588	1079	1593	1539	1051	1308	
Senegal		5	23	15	57	32	8	176	40	35
South Africa	n.a	n.a	n.a	n.a	993	816	3811	550	300	

Source: Derived by the authors from World Bank Indicators 2000 and the Heritage Foundation, Index of Economic Freedom 2001

There is some evidence that the relatively small amounts of FDI inflows into African economies are not reflections of unsatisfactory returns for investments in the continent. On the contrary, available

statistics suggest that apart from Asia and the Pacific region, foreign investments in Africa attracted higher returns than elsewhere in the world between 1983 and 1990. Indeed US FDI in Africa attracted higher returns than from any other part of the world between 1991 and 1997 see Table 4.

Table 4: Rates of Return for US FDI in Africa and Other Regions 1983 – 1997 (%)

Region	1983	1985	1987	1990	1993	1995	1996	1997
Africa	17.7	17.3	15.5	24.2	24.8	35.3	34.2	25.3
Asia/Pacific	27.6	18.1	20.3	27.6	20.7	20.2	19.3	16.2
Latin Amer.	7.0	9.5	9.5	13.0	14.9	13.1	12.8	12.5
Developed								
Economies	14.9	13.4	13.2	17.2	16.9	15.8	15.3	14.0
All Nations	13.0	12.6	13.4	14.3	11.1	13.3	12.5	12.3

Source: United Nations, FDI in Africa: Performance and Potential, 1999

Investments in Africa would appear to be quite lucrative. The continent's inability to obtain a greater share of the world's FDI inflows must be in reasons other than profitability.

Impact of Economic Openness

With strict trade restrictions still in place in many African countries, economic openness can only be discussed in relative terms. Nevertheless, efforts by some of the continent's nations to move towards a more open economy had started to be notices some eight years ago with encouraging experiments in Uganda, Mali, and Ghana. (Quelch and Austin in 1993, Sachs 1995). We have already indicated that economists often measure economic openness by the extent to which a nation allows free trade, measured, rather narrowly, by the annual volume of imports into the given economy. This in then expressed as a percentage of the nation's GDP to facilitate comparisons between nations. This is what we have matched against per capita annual inflows of FDI for the same African nations between 1990 and 1998. It is shown in Table 5.

Table 5: Trade Openness and FDI Flows 1990 – 1998

Country	Imports as % of GDP	Cumulative FDI ($ Millions)	FDI Inflow Per Capita ($)
Algeria	26.3	271	8.68
Botswana	40.0	540	337.0
Ivory Coast	33.6	1557	94.9
Egypt	28.0	5388	77.5
Ghana	34.0	426	21.4
Kenya	34.0	93	3.4
Mauritius	66.3	133	110.0
Nigeria	34.3	5619	44.3
Senegal	36.0	368	35.7
South Africa	22.0	5975	135.0

Source: Developed by the authors from World Bank Development Indicators and U.S Census Bureau, International Data Base.

In relative terms, the analysis does reveal that inflows per capita have been highest in those nations with more relatively liberal trade policies. This is evident from the strong performance of Botswana and the island nation of Mauritius. Similarly, the highly restrictive trade policies of Kenya, Ghana, and Nigeria are well reflected in their low per capita FDI attraction over the period. Nigeria's figures would in fact have been worse given the draconian and restrictive trade policies she followed in the 1980's and 1990's (Anyamele 1997). The explanation seems to be that Nigeria's FDI is largely confined to continued investment in her oil industry. Such investments tend to be driven by the needs of the industry operators and commitments made in previous years. Investments are often such made even when conditions are not economically or politically conducive. South Africa's situation is also unique. Huge inflows followed the end of apartheid and for a country hitherto cut off from the rest of the world, many nations and companies were eager to enter the new 'open' economy even if some restrictions were severe as we have noted, the ability of South Africa to attract increasing FDI inflows has been diminished in the past three years. Probably the effect of existing trade restrictions may have started to take effect. The figures, on the whole, support the conclusion that in Africa, liberal trade policies tend to encourage inflows of FDI while restrictive trade policies deter such flows.

Impact of Freedom

Our analysis is based on the Index of Economic Freedom as composed by Gerald O' Driscol, Kim Holmes and Melanie Kirkpatrick (Heritage Foundation 2001). Their 2001 ranking of nations is based on ten key factors that affect the rate of FDI flows into various nations. The factors include trade policy, capital inflows and investment; they also include laws governing, and government attitude to, property rights. The index for each country is a score between 1 and 5. The interpretation is that the lower the score, the more free the economy.

Not surprisingly, the 2001 indices show that African countries, even with improvements over previous years, have the least free economies in the world. Every other region of the world has at least one country whose economy is rated completely free. There were 5 of such economies in North America and Europe, 4 in Asia and 1 (Bahrain) in the Middle East. Scores in North America and Europe range from 1.8 to 4.0; 2.00 to 4.75 in Latin America and the Caribbean (Cuba is the main drawback) and from 2.00 to 4.45 in the Middle East. African countries scored between 2.80 and 4.80. Seven African countries had severely repressed economies. The performance of African countries is presented in Table 6 and they are based on cumulative FDI per capita inflows and average annual scores in the Index of Economic Freedom between 1997 and 1999.

Table 6: FDI Inflows and Economic Freedom in Africa 1997 – 1999

Country	Cumulative FDI Per Capita ($)	Average Annual Index of Economic Freedom Score
Algeria	8.68	3.42
Botswana	337.1	2.87
Ivory Coast	94.9	3.41
Egypt	77.57	3.48
Ghana	21.40	3.18
Kenya	3.00	3.15
Mauritius	111.0	2.81
Nigeria	44.30	3.27
Senegal	35.70	3.26
South Africa	135.8	2.97

Source: Developed by the authors from World Bank Indicators and Heritage Foundation, Index of Economic Freedom for various years.

The authors of the Index of Economic Freedom have shown that their results were based on some rigorous research, but measuring freedom does pose inherent problems of objectivity. One should, therefore, be cautious in using these indices. They do, however, show that the freer economies in Africa have attracted higher FDI per capita than those economies that are not so free. Thus the three countries whose average annual indices of economic freedom were below 3.00 had the highest FDI inflows per capita. They are Botswana, Mauritius and South Africa. Low per capita FDI flows into Kenya, Nigeria, and Algeria are consistent with their relatively 'unfree' economies. Egypt does not follow the pattern. Her relatively high FDI inflow does not reflect the 'unfree' state of their economy. On the whole, though, our analysis appears to support the view that in Africa, those economies that have less restrictive trade policies and which enjoy greater freedom attract more FDI inflows than those which are highly controlled.

Impact of Legal Structure

A conducive legal environment is essential for attracting FDI and we have already indicated that one measure of an enabling environment is adequate protection for property rights. The Heritage Foundation again ranks and scores nations of the world annually on the extent to which they have adequate safeguards for property right. The scores range from 1, for countries with full safeguards for property rights to 5 for nations, which do not. Latest rankings and scores for the African nations being reviewed are given in Table 7.

Table 7: Property Rights Protection Scores and Rankings 2001

Country	Score (1-5)	Rank in the World
Algeria	4	90
Botswana	2	68
Ivory Coast	4	75
Egypt	3	120
Ghana	3	84
Kenya	3	87
Mauritius	2	58
Nigeria	4	97
Senegal	3	81
South Africa	3	81

Source: Heritage Foundation, Index of Economic Freedom 2001

The figures here again confirmed what we have observed all along. The nations with relatively superior safeguards for property rights- Botswana and Mauritius- have attracted higher FDI per capita than those nations whose property rights protection is lax and unreliable- Nigeria, Algeria, Kenya, and Egypt. More generally it has become clears that nations, which have restrictive trade policies in the continent, whose economic and political arrangements are not very free and which do not have adequate safeguards for property rights are not able to attract FDI in large volume and at an increasing rate. The implications for policy makers in the continent are clear: progress towards free trade, economic and political freedom, stability and transparent legal processes need to be speeded up.

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