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Foreign Direct Investment as a Key Driver for Trade, Growth and Prosperity: The Case for a Multilateral Agreement on Investment

A View from Sub-Saharan Africa: Fresh Opportunities for Integration

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The issue of FDI as a driver for trade and development holds great resonance in Africa. FDI flows to Sub-Saharan Africa remain modest, yet have increased steadily over the past decade. Inbound direct investments have exceeded total aid flows since 2005, and in 2011 they stood at US$ 36.9 billion – equivalent to 2.4% of global flows.[27] While the continent may have been a comparatively peripheral region in the transformations that have occurred in the global economy over the past two decades, a growing number of voices in corporate and analytical circles recognizes that African markets have serious future investment potential.
While acknowledging the many challenges that still need to be overcome to effectively mobilize resources towards advancing the socio-economic objectives of a very diverse set of nations, a noticeable sense of African economic dynamism supports this positive perception. Several developments have raised the profile of an important number of African countries as promising investment destinations.

The first such development is rapid GDP growth. Continent-wide output expanded by 5% in 2012, and over half of Sub-Saharan Africa's 48 countries are forecast to grow above that rate in the coming years.[28] Although this upward trend from an admittedly low base says nothing about the quality or sustainability of growth, it prompted the *Financial Times* to identify Africa's "road to prosperity" as one of the marked "bright spots in the world economy" in an end-of-year editorial.[29] A second notable element is the macroeconomic resilience demonstrated by many African nations following the financial crisis and the subsequent depressed demand from traditional export markets in Europe and the United States. This resilience is perceived as the consequence of prudent economic management and greater political stability, as well as China's intensifying engagement with the continent as a commodity importer and large-scale investor – especially in infrastructure. Demographics offer a third component of Sub-Saharan Africa's inherent potential. Seventy percent of the population is under the age of 25, and the region will enjoy a favourable dependency ratio – or demographic dividend – over the coming generation. This provides a great opportunity if capitalized upon through employment creation and broad-based growth. These young and increasingly urban citizens will also be responsive to the possibilities made available by the rise of telecommunications and information technology that is taking hold across the continent. Finally, the political process of regulatory reform has gained momentum in many African nations, with policy efforts targeted at strengthening domestic business environments and investment frameworks. Within these broadly encouraging dynamics, a general set of challenges in the context of international trade and investment is worth highlighting.

While Sub-Saharan Africa needs to attract investment and absorb technological and managerial know-how in virtually every sector – from agriculture to manufacturing, services and infrastructure development – the global market for FDI is hugely competitive, and investors have become highly sensitive to political and macroeconomic instability. Despite low wages, for example, the region has largely been bypassed by the shifting geography of efficiency-seeking investments in global production chains in labour-intensive manufacturing, due to poor levels of productivity and competitiveness. Furthermore, while there is mounting evidence that global firms are now looking to tap into rising African consumer affluence,[30] most African nations, with the exception of South Africa and Nigeria, remain at a disadvantage compared to other fast-growing regions with respect to market-seeking incentives, owing to narrow markets and weak regional integration. Renewed efforts within the East African Community and the South African Development Community to strengthen integration dynamics can be applauded in this light. And even though Africa's successes of the past decade are far from restricted to commodities and natural resources, extractive industries continue to attract nearly half of inbound investment flows.

FDI can serve as a potent tool for economic development and poverty reduction in Sub-Saharan Africa – most notably through employment creation, knowledge transfer and diversification out of low-value, resource-based production. Many countries in Africa have the capacity to attract increased flows of private capital from both developed and emerging nations. Reaping the dividends of these investments will require establishing productive market-state relations that align economic, social and environmental objectives.

There are a few promising and diverse examples from Africa's southern cone. For example, Mozambique is engaged in a process of tropical agricultural development with Brazilian and Japanese investments that could offer significant long-term rewards. Likewise, South Africa has successfully opened renewable energy tenders for independent power producers with the participation of European and Indian partners, among others. Botswana can be credited with an imperfect, yet commendable, record of governance and poverty reduction in its diamond-led economy. And Lesotho is capitalizing on US African Growth and Opportunity Act preferences to attract capital to its vigorous textile and clothing industry. Mauritius has also gradually developed into a regional services hub on the back of a strategy originally based on the establishment of SEZs that cater to labour-intensive apparel manufacture.

The example of Mauritius merits attention in light of the historical importance of the textile industry as a route to economic development and structural transformation through low-wage employment creation. Sub-Saharan Africa's textile industry has suffered immensely from Asian competition over the past decade. Production has declined, businesses have closed and jobs have been shed. Low-income Madagascar is a case in point. As wage pressures in China and Asia continue to intensify in the coming years, there is no reason why African nations should not draw renewed interest from key drivers in an industry with highly fragmented global production networks. To attract foreign investment, African countries should narrow skill gaps and logistical bottlenecks, and create stable environments that incentivize inward investment in labour-intensive production. Strategies will differ, and may rely in the short to medium term on inducements found in industrial or export processing zones. Yet recent experience in Asia suggests that, given a minimum level of policy foresight and capable economic leadership, there is a substantial potential for business development, productivity gains and job creation in the textile industry.

Ensuring that inbound FDI flows act as a source of inclusive and sustainable growth in Sub-Saharan Africa, however, calls for some precautionary remarks. In domestic environments that are often characterized by weak institutions, some degree of corruption and limited administrative capacity, there is a risk that social and environmental regulations will be undermined to accommodate investors or global sourcing arrangements. The death by fire of over 900 textile workers in Dhaka in November 2012 due to unacceptable working and safety standards is a tragic reminder of the shortcuts that can be taken to achieve global efficiency gains. International companies have a responsibility to move beyond minimum levels of compliance to safeguard the social and environmental integrity of their investments and supply chain strategies. Another point to be considered from an investment policy and governance perspective is that technological transfers and knowledge spillovers that are often associated with FDI and GVCs are not automatic.[31] Upgrading to higher-value activities can be a challenge for many African nations, and will warrant policy adjustments based on domestic specificities and national objectives.

In conclusion, progress across the African continent over the past decade has not been uniform, but many nations are creating the conditions to enhance their participation in international trade and investment flows in goods and services. This opportunity must be seized.