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# Foreign direct investment and other private capital flows to Sub-Saharan Africa

Gunnar Fors

May 1997

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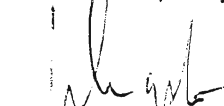
## PREFACE

This study is a background study for Sida's financial sector support strategy. The focus is on southern and eastern Africa. It belongs to a series of background studies commissioned by Sida's task force for financial sector development.

The study included here is a desk study by Gunnar Fors. It describes the *Foreign direct investment and other private capital flows to Sub-Saharan Africa* and discusses its role in development. The study also contains recommendations on how the development of this sector may be supported by an aid donor agency.

The author is fully responsible for the text.

Stockholm, May 1997



Jan Engström  
Secretary of the Sida Task Force



Report prepared for  
Swedish International Development Cooperation Agency (SIDA)

**FOREIGN DIRECT INVESTMENT AND OTHER PRIVATE CAPITAL  
FLOWS TO SUB-SAHARAN AFRICA**

by

Gunnar Fors

1997-04-14



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## **Executive summary**

This study analyzes the recent development of private capital flows to Sub-Saharan Africa, with emphasis on the Swedish program countries. These flows include foreign direct investment (FDI), portfolio equity, commercial bank lending and other private flows. The focus is on FDI, since this constitutes the most significant net inflows of private capital to the region. Moreover, FDI seems to have a larger real impact on the recipient countries, compared with private flows such as portfolio equity and bank lending.

FDI to developing countries have been growing rapidly in the recent past, from around 34 billion dollars in 1990 to around 110 billion dollars in 1996. In the same period, substantial increase in other private flows, such as portfolio equity and commercial bank lending, have also been observed. It is generally argued that these inflows have a positive overall impact on the growth potential of the recipient host countries, since they usually bring about investments in modern technology, improved marketing channels and export opportunities, demonstration effects on other investors, and more generally the benefits of an increased integration with world markets.

Most of the capital flows to developing countries are, however, concentrated to Asia, Latin America, and Eastern Europe. Although FDI inflows increased strongly also in Sub-Saharan Africa during the 1990s, from around one billion dollars in 1990, to almost three billion dollars in 1995, the levels remain modest. Some claim that Sub-Saharan Africa has largely missed out the surge in international private flows in the 1990s.

It can, however, be argued that the increase in capital flows, particularly FDI, to the countries in Sub-Saharan Africa observed in recent years is important in relation to the limited private domestic investments taking place. Moreover, even small inflows may have important demonstration effects on domestic and other foreign investors. These private flows could be crucial for the future growth potential in the region, especially when official development assistance is on the decline, both in absolute and relative terms.

Despite the low level of FDIs in absolute terms, the share of FDI inflows to gross fixed capital formation is substantially higher in Sub-Saharan Africa compared with other developing regions. The relative importance of FDI in capital formation has also increased markedly over time. Portfolio equity flows and commercial bank lending to the countries in Sub-Saharan Africa are yet very small, but recent signs of an increase, are encouraging. In addition to recorded capital inflows, we also have substantial private transfers by individuals, of which a large portion is believed to be related to returning flight capital.

The current capital inflow episode to developing countries represents a sharp break from the experience of the debt crisis. While this surge in capital constitutes a welcome relief from the constraints of credit rationing, it also poses some policy challenges. Massive inflows of foreign capital can have problematic macroeconomic effects if not adequately counteracted by economic policy. In particular, large short term capital inflows might spur inflationary pressure if the resources are not efficiently intermediated to productive investments. Exchange rate appreciation may also be a problem during periods of massive inflows.



However, in the case of Sub-Saharan Africa, private flows are mainly attributed to long term FDI, which has been shown to have a less adverse impact on macroeconomic stability. FDI is primarily for productive investment in real assets in the host country. Nevertheless, it is crucial that the countries in the region strive towards macroeconomic stability, and it should be pointed out that more research is needed about the impact of FDI and other private capital inflows on stability in Sub-Saharan Africa. Since many countries in the region still face serious macroeconomic problems, there is a need for caution and an adequate policy response, including structural reforms, as means of minimizing possible adverse effects related to capital inflows.

A number of studies have investigated the relationship between economic growth at the aggregate level and inward FDI. On the whole, the results suggest a positive relationship, although it is difficult to establish the direction of causation. It is likely that there is a two-way relationship between FDI and growth. Furthermore, this relationship especially holds if the host country has attained a minimum educational level. This suggests that countries must have a certain "receiver competence" in order to gain from spillovers and other benefits related to FDI. In countries with a low level of educational attainment, FDI projects may become "enclaves" relative to an otherwise backward domestic economy.

The majority of African countries are keenly interested in receiving FDI and other private capital inflows, which is in sharp contrast to the situation in the 1960s and 1970s when most governments were hostile towards foreign capital. Most countries in the region have recently improved their regulatory frameworks relating to FDI, and provided various incentives aiming to attract FDI, or are in the process of doing so. However, this has not yet led to any substantial volume of FDI inflows. Of course, the response by investors to deregulation and incentives takes time, and may not yet have materialized.

There are, however, still a number of crucial conditions for FDI lacking in the region. In several aspects Africa as a whole does not compare favorably to foreign investors. This includes; (i) inadequate institutions, legislation and financial sectors, (ii) poor infrastructure, (iii) low levels of education and skills, (iv) small domestic markets, (v) low reliance on privatization and debt equity swaps to attract FDI, (vi) debt overhang and shortage of foreign exchange, and (vii) political instability. In order to attract more FDI and other private flows, these conditions must be improved. Deregulation and incentives with respect to FDI will have a limited impact if other basic conditions are not met.

The following four broad areas of involvement by SIDA is recommended:

*First*, of highest priority, relating to conditions in host countries, is to improve the business climate, increase privatization, reduce bottlenecks relating to infrastructure, and increase training. All these efforts can be pursued at a rather detailed level, i.e. removing specific bottlenecks relating specifically to a potential FDI inflow.

*Second*, also of high priority, is to assist program countries to take advantage of the linkages to South Africa, and possibly other more advanced SSA countries, as regional growth poles in their effort to increase capital inflows. Hence, it should be important to promote regional integration.

*Third*, promotion of Swedish enterprises to invest in program countries. This area may be

explored in the future when business conditions in host countries are improved. In this respect, it should be highlighted that Swedish private investments in Sub-Saharan Africa (and other program countries) are very small to date. This is partly related to the lack of colonial and other historical and cultural ties with the region.

*Fourth*, SIDA should continue to participate in multilateral efforts, such as those undertaken by the World Bank, IMF, United Nations and European Community, both by providing financial resources, and to actively stimulate the policy dialogue.

Needless to say, it is important that SIDA continues to assist countries in improving the workings of the economy, e.g. a stable macroeconomy, an open trade regime, domestic deregulation, which has a positive impact at a more general level, including inflows of capital.



## 1. Introduction

Foreign direct investment (FDI) and other private capital flows to developing countries have been growing rapidly in the recent past, faster, indeed, than international trade. For example, FDI inflows to developing countries increased from around 34 billion dollars in 1990 to around 110 billion dollars in 1996 (World Bank, 1997). We can also observe an substantial increase in other private flows, such as portfolio equity and commercial bank lending. It is generally argued that these inflows have a positive overall impact on the recipient host countries, including the provision of capital, modern technology, marketing channels and export opportunities, demonstration effects on other investors, and more generally the benefits of an increased integration with world markets.

However, most of these inflows were to Asian, Latin American, and Eastern European countries. Although FDI inflows increased strongly in Sub Saharan Africa (SSA), from slightly more than one billion dollars in 1990, to almost three billions in 1995, the levels are low. Some argue that SSA has largely missed out the surge in international private flows in the 1990s. To be sure, the flows to SSA are meager in dollar terms. However, in this report, it is argued that the increase in FDI and other private foreign capital flows to SSA observed in the 1990s are important and substantial in relation to the limited private domestic investments taking place. Moreover, even small dollar flows may have important demonstration effects on both domestic and foreign investors. The private flows should be crucial for SSA's future growth, especially when official development assistance (ODA) is on the decline, both in absolute and relative terms.

This study analyzes the recent development of private capital flows to SSA,<sup>1</sup> with

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<sup>1</sup>SSA figures in this report exclude South Africa. However, South Africa, which is classified as a developed country, is also analyzed in the report.

emphasis on the Swedish program countries.<sup>2</sup> These flows include FDI, portfolio equity, commercial bank lending, and other private flows. The focus is on FDI, since it is here that we observe the largest net inflows to SSA countries, and also since FDI generally have a larger real impact on the recipient countries, compared with other private flows. However, portfolio equity flows and commercial bank lending will also be dealt with, as these inflows have shown positive trends more recently, and can potentially be important in the future.

The report is structured in the following way: In section 2 we discuss the effects of inward FDI and other private inflows on developing host countries, and provide some empirical evidence. Next, in section 3, factors determining inward FDI are reviewed. Recent trends, up to 1995, of private foreign flows to SSA, and Swedish program countries, are then analyzed in section 4. An assessment of the future potential of FDI to SSA countries is undertaken in section 5, and an evaluation of the role of South Africa, and regional integration, in this context as a growth pole in section 6. Finally, section 7 provides recommendations and discusses possibilities for SIDA to promote private capital flows to the Swedish program countries.

## **2. Effects of FDI and other private capital inflows on host countries**

This section discusses different effects of capital inflows on recipient countries. In the case of FDI, clearly, capital is not the only assets that multinational enterprises (MNEs) bring to host countries. Other assets include technology, management know-how, marketing and exporting skills, and these assets may in some cases, even have a more important impact on host countries than the inflow of conventional capital itself. This is what distinguish FDI from the other kinds of private

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<sup>2</sup>The Swedish program countries in Africa comprise; Angola, Botswana, Ethiopia, Guinea-Bissau, Kenya, Mozambique, Namibia, South Africa, Uganda, United Republic of Tanzania, Zambia, and Zimbabwe. Eritrea is also a program country, but excluded in most of the analysis as little information is available for this newly independent nation.

inflows. FDI is more long term in character and is directly linked to the operations of foreign owned affiliates located in the host countries.

## **2.1. Investment and employment**

### *Investment*

FDI or other private inflows bring capital that can be invested in host countries. In the case of FDI, it is important to distinguish between a new investment project, and an acquisition of an already established local firm. In the former case new physical investments take place, while in the latter case no new physical investments may necessarily be involved (at least in the short term). In developing countries the share of acquisitions in all foreign establishments is much lower than in industrial countries, which is probably explained by the fact that there are few companies to acquire.<sup>3</sup>

It is also of relevance to ask whether FDI substitutes, complements, or has no effect on domestic investments. If FDI opens up new markets in a country, or is related to export production or import substitution, that was not previously taking place in the country, the foreign investments should not substitute for domestic investments. If, on the other hand, the FDI project competes with domestic producers in a given market, FDI may be substituting domestic capital. Finally, if there are demand or supply linkages between foreign and local firms in a host country, this may lead to a complementary relationship between FDI and domestic capital. Borensztein *et al.* (1995) investigating FDI flows to a large number of developing countries, found that FDI on average leads to a net increase in total investment in the economy, which, suggests a

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<sup>3</sup>Braunerhjelm *et al.* (1996), provide evidence from Swedish MNEs that acquisitions are less common as a mode of entry in developing countries and transition economies.

complementary relationship between FDI and domestic investments.<sup>4</sup>

The contribution of FDI, and other private inflows, is potentially important for SSA countries, particularly since domestic savings and investments are so low. Gross domestic investment as a share of GDP has even been decreasing in the region between 1980 and 1993 (UNCTAD, 1995a). On the other hand, the share of FDI in gross fixed capital formation is higher in SSA than the average for developing countries, and the role of FDI has increased over time in the region (Table 2). In 1994, FDI accounted for over 11 percent of gross fixed capital formation in SSA, compared with 7.5 percent in all developing countries. In resource rich countries like *Angola* and *Zambia*, FDI, taking place mainly in extraction, contributed to as much as 56 and 19 percent of overall capital formation, respectively. However, most of the Swedish program countries had a lower share of FDI in capital formation than the SSA average (Table 2).

Moreover, FDI inward stock as share of GDP, has been at a higher level in SSA countries than the developing country average (Table 3), and the FDI stock in GDP has been increasing over time: it doubled in ten years, from around 10 percent in 1985 to 20 percent in 1994. This is some indication that FDI, despite its small volume is an important factor in countries' total output.<sup>5</sup> Hence, altogether the data suggest a greater role over time for FDI in the region, both in absolute and relative terms, and a poor development of domestic investments.

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<sup>4</sup>The relationship between FDI and domestic investments is likely to depend much on which sector we are concerned with, but no systematic cross-country data are available to investigate this. It is e.g. likely that FDI in resource extraction, which may be enclaves in the domestic economy, have little relation with domestic investments, while FDI in manufacturing or services, with more linkages to local firms, may in some cases lead to additional domestic investment.

<sup>5</sup>It should be noted that the *share of FDI inward stock in GDP*, does not directly measure the contribution to FDI in output. However, the FDI stock is part of a country's overall capital stock, which is an input along with e.g. labor determining the output.

## *Employment*

Like investments, discussed above, the impact of FDI on employment in host countries largely depends on the nature of the FDI project (i.e. whether FDI substitutes or complements domestic activities). In 1992, MNEs from all source countries employed around 29 million people in their foreign affiliates world-wide. Of these, 12 million were in developing countries, and in this figure as much as half is related to China alone. The employment by MNEs in developing countries has risen quite rapidly over time, but the increase is mainly attributed to China, where foreign affiliate employment doubled from 3 to 6 million between 1990 and 1992 (UNCTAD, 1994).

The figure of 12 million employees in foreign affiliates located in developing countries, implies that on average less than two percent of the economically active population are employed by foreign affiliates. Hence, in most host countries, we can not expect any substantial *direct short term* impact on aggregate employment from FDI. In addition, those employed by foreign affiliates will not be the poorest people in rural areas, but rather well educated people in cities. The *long term* and *indirect* employment effects of FDI, may, however, be substantial, depending on the linkages between foreign affiliates and the domestic economy. The inflow of foreign capital and technology influencing the overall efficiency and growth in the economy should also lead to increased employment in the longer term (see Box 1 about the impact of FDI in Bangladesh).

No systematic figures are available on the effect on employment in SSA. In 1989, foreign affiliates in *Botswana* had 35.000 employees, of which 6.000 were in manufacturing.<sup>6</sup> The employment by foreign affiliates in *Kenya* was in 1995 close to 28.000, which comprised 2.5 percent of the national labor force (UNCTAD, 1996). Mauritius, which has been successful in

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<sup>6</sup>These 6.000 employees constituted as much as 36 percent of total employment in Botswana's manufacturing sector (UNCTAD, 1994).



attracting export oriented manufacturing FDI, had 35.000 employees in foreign affiliates in the manufacturing sector in 1990, which accounted for as much as 26 percent of the country's economically active population. (UNCTAD, 1994). In the case of *Zimbabwe*, foreign affiliates remained important employers in manufacturing, despite large disinvestment by foreigners during 1980-93 (UNCTAD, 1995a). This indicates that the current flow of FDI may not necessarily, at least in the short term, be related to the employment by foreign firms.

## **2.2. Spillovers from foreign firms to the domestic economy**

There are good reasons to believe that FDI may be more productive than domestic investment. Already Hymer (1960), and more recently, e.g. Graham and Krugman (1991), have argued that since domestic firms have better knowledge about, and access to, domestic markets, MNEs must have some competitive advantage in order to enter the host country and be successful there. It is likely that MNEs enjoy lower costs than domestic competitors resulting from higher productive efficiency, related to superior technology, management skills or marketing know-how. In this subsection it is discussed to what extent these advantages held by foreign firms may "spill over" to domestic firms, and more generally, to the domestic economy

### *Productivity spillovers*

Spillovers from MNEs to local firms in the host country are believed to basically take place in two stages. *First*, MNEs transfer knowledge to their foreign affiliates. Fors (1996) utilizes data on Swedish MNEs and their foreign affiliates, and finds that the MNEs transfer knowledge generated in Sweden to foreign affiliates located in developed, as well as in developing countries.<sup>7</sup>

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<sup>7</sup>For the Swedish MNEs, it is found that technology transfer to foreign affiliates located in developing countries (mainly Latin America), is partly explained by deliveries of intermediary and capital goods from the Swedish parent company to the foreign affiliates. This suggests that technology is embodied in goods used as inputs in production taking

*Second*, spillovers take place from foreign affiliates to domestic firms in the host country through various channels.

In their survey of spillovers from MNE activity, Blomström and Kokko (1996), suggest that one of the most important factors as to why developing countries now try to attract FDI may be the prospects of acquiring modern technology. From a large number of empirical studies, they conclude that spillovers from FDI do exist and may have substantial effects on host countries. These benefits take the form of externalities, which are commonly referred to as "productivity spillovers"; (i) domestic firms or industries may be able to improve their productivity through backward, and to some extent forward, linkages with the foreign affiliates of MNEs,<sup>8</sup> (ii) domestic firms may copy technologies used by the foreign affiliates, or (iii) recruit workers trained by foreign affiliates.<sup>9</sup>

It can be expected that the spillover effect is more important in less developed countries, where indigenous technical skills and information are in shorter supply. Of course, this may not apply to the poorest host countries which lack a minimum threshold level of receiver competence to take advantage of the foreign technology (Blomström, 1992), and where the foreign affiliates develop into "enclaves" in an otherwise backward economy.<sup>10</sup>

A case study of FDI in the *Kenyan* soap industry reports that the entry of foreign affiliates

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place in the foreign affiliates (Fors, 1996).

<sup>8</sup>It is sometimes argued that there are few linkages between foreign affiliates and domestic firms in developing countries. However, Reuber *et al.* (1973), in a comprehensive study of foreign affiliates in developing countries, found that over a third of all inputs and services purchased by foreign affiliates were procured from local suppliers. This share is likely to have increased over time, since it has been shown that the longer foreign affiliates are established in a host country, the more they use local suppliers.

<sup>9</sup>In a study of training and the spread of managerial skills in *Kenya*, Gerschenberg (1987) found that foreign affiliates offer more training to their managers than do private local firms, although not more than joint-ventures or state-owned firms.

<sup>10</sup>Kokko (1994), examining the impact of FDI in Mexico, finds that when MNEs operate in enclaves, where neither products nor technologies have much in common with those in domestic firms, there is little scope for learning, and spillovers may not materialize.

introduced mechanized production, and that the incumbent local firms found themselves unable to sell handmade soap in the urban areas (Langdon, 1991). Instead, they were forced to mechanize the production themselves to stay in business. Foreign entry into the *Kenyan* footwear industry, appears to have had a similar impact on the local firms (Jenkins, 1990). Econometric studies of spillovers have been undertaken by relating the foreign share of an industry's value-added or employment, to the productivity of domestic firms in the same industry. Most studies provide positive evidence on spillovers (Blomström and Kokko, 1996).

*"Competition spillovers"*

Entry by MNE affiliates may alter the competitive situation on the market, and force domestic firms already in the market to improve their efficiency, in order to protect their market shares and profits. This can have different effects on the overall competition, depending on which industry we are analyzing, and what was the initial situation. The entry of MNEs into a monopolistic industry is likely to increase competition and put pressure on domestic firms to become more efficient or exit. Concerns have been raised that entry of MNEs outcompetes domestic firms resulting in a new monopolistic situation instead. See e.g. Newfarmer and Mueller (1975) in the case of Brazil and Mexico. The existing evidence, however, on the whole suggest that MNEs mainly enter already concentrated industries, and that the entry initially add to the number of firms in the market. In the longer run, the foreign entry may in some cases increase market concentration, but the entry usually enhance efficiency (Caves, 1971; Blomström and Kokko, 1996).<sup>11</sup> In other cases, entry by MNEs may open up entirely new markets serving

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<sup>11</sup>This is especially the case if e.g. import protection *does not* provide an easy life for the foreign affiliate (Blomström and Kokko, 1996). For the purpose of efficiency for foreign affiliates it is important that domestic markets are not distorted, and that the trade regime is open. Balasubramanyam and Sapsford (1996), finds that the overall positive relationship between inward FDI and host country growth does not hold in the case of host countries pursuing an "import substitution" trade regime, suggesting that FDI lured by high import tariffs may no be efficient.

domestic consumers, or export production operations that were not previously taking place in the country.

### *Market access spillovers*

Domestic firms may also benefit from "market access spillovers", since MNEs generally possess marketing know-how to enter world markets with exports, and also due to the fact that MNEs have access to established international distribution and marketing networks, including transportation and information systems. Hence, MNEs may pave the way for domestic firms to enter the same export markets, and MNEs may disseminate information about potential foreign markets for domestic exporters.<sup>12</sup> If local firms are subcontractors to export oriented foreign affiliates, local firm may *indirectly* obtain access to export markets. Market access spillovers should be particularly important for developing countries in Africa, where local firms usually lack marketing skills and export contacts (see Box 1 regarding Bangladesh).

### **Box 1. FDI and spillovers in the clothing industry in Bangladesh**

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In the clothing industry in Bangladesh, FDI has had an instrumental role in promoting exports. The entry by a few MNEs introduced quality control which was later imitated by domestic clothing firms. The improvement in quality made it possible for the local companies to compete on export markets. The industry's exports raised from a negligible 55,000 dollars in the early 1980s, to 1.2 billion dollars in the early 1990s, which constituted more than half of the country's overall exports. This development had a major impact on employment. An estimated 800,000 women were employed in the hundreds of clothing factories established in urban areas, and an additional 3.5-4 million women were employed within the industry in rural small scale subcontracting activities.

The important contribution of FDI was the introduction of quality control, not the supply of physical capital or financial resources. The exports and employment came mainly from domestic companies imitating the MNEs. Although the FDI inflows are still small, the overall success of the industry now appear to attract new investors from e.g. South Korea, Malaysia and Japan. It is possible that these new entries will bring new methods that can be imitated by local firms in a second round.

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*Source:* Economist (1995)

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<sup>12</sup>For example, Japanese trading companies played an important role in the development of East Asian firms' exports from the early 1970s onwards.

What about spillovers in SSA countries, where FDI is concentrated to few industries with a bias towards the primary sector? Let us first underline that FDI to SSA countries is *not* only taking place the primary sector, as is commonly believed. Estimates from the 1980s, indicate that 55 percent of the FDI stock in SSA was related to the primary sector, 28 percent to the secondary sector, and 20 percent to the tertiary sector (UNCTAD, 1995a). Some examples from the Swedish program countries: in *Kenya*, only about 5 percent of the FDI inflows (during 1982-85), were related to the primary sector; in *Zambia*, despite the dominating role played by copper, less than half the FDI inflows (1980-83) were in the primary sector; and in *Zimbabwe*, less than one third of the inward FDI stock (1981) was in the primary sector (UNCTAD, 1995a). This suggests a more heterogenous pattern of FDI in SSA countries, and points to a potential in other sectors than resource extraction.

Nevertheless, it should be pointed out, that in enclave-like resource extraction ventures, spillovers are usually limited. For example, in the oil business in SSA, foreign capital play an important role in sharing the high exploration and development costs, bringing technology and expanding exports, but there are few linkages to the domestic economy. However, the experience of the diamond and other extractive industries in *Botswana*, demonstrates that FDI in resource extraction may be further diversified into other production stages (Box 2).

## **BOX 2. Botswana: Resource-led growth and FDI**

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Africa has long been dependent of FDI for investments and knowledge transfer for the development of its natural resources. Botswana is a country that has managed this successfully. At independence in 1966, Botswana was one of the poorest countries in the world. Since then it has recorded among the highest growth rates of all countries. The country's success has been based on the expansion of mining and quarrying. Their share in the economy raised from one percent in the early 1970s to over 50 percent in 1988-90. Diamonds have predominated, although the country also has deposits of gold, copper, coal and soda-ash.

With limited domestic resources and mining knowledge, the government has sought to attract FDI. Capital, entrepreneurship and technology have largely come from the South African diamond company De Beers. Botswana has provided a favorable regulatory and policy framework for investors, including freely available import licenses, and liberal exchange rate controls. As a result, inward FDI has risen considerably in the 1970s and 1980s, although a fallback in the share of FDI in GDP has been recorded more recently (see Tables 1-3). Botswana has avoided state investment in the mining industry, and the macroeconomic policy has ensured a relatively stable exchange rate.

Despite Botswana's success, the strong dependence on natural resources has been questioned. The future of the economy is highly dependent on the diamond market, and the government has stressed the need to diversify into processing of primary products and

manufacturing. However, in the diamond business, the country has diversified into cutting and polishing. This diversification has involved large amounts of FDI, particularly from the US. Some diversification has also taken place in the soda-ash industry, with much of the capital provided by three South African MNEs.

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*Source:* UNCTAD (1995a)

### **2.3. Macroeconomic effects**

The current capital inflow episode to developing countries represents a sharp break from the experience of the debt crisis. The magnitude of flows nearly matches that which preceded the debt crisis, although the role of FDI is now much greater. While this surge in capital to the developing countries, certainly constitutes a welcome relief from the constraints of credit rationing for many countries, it also poses some policy challenges. Massive inflows of foreign capital can have problematic macroeconomic effects if not adequately counteracted by economic policy. In particular, large short term capital inflows might spur inflationary pressure if the resources are not efficiently intermediated to long term productive investments. Massive capital inflows may also lead to an exchange rate appreciation, in turn creating balance of payment problems

However, private flows to SSA are mainly attributed to long term FDI, which has been shown to have a less adverse impact on macroeconomic stability. FDI is primarily for productive investment in real assets in the host country. Other inflows such as portfolio equity and commercial bank loans, which have caused some macroeconomic problems elsewhere, e.g. Latin America, have so far been small to the region, both in absolute and relative terms.<sup>13</sup>

Nevertheless, it is crucial that the countries in the region strive towards macroeconomic stability, and it should be pointed out that more research is needed about the impact of FDI and other private capital inflows on stability in SSA countries. Since many countries in the region still face serious macroeconomic problems, there is a need for caution and an adequate policy response, including structural reforms, as means of minimizing possible adverse effects related to capital inflows.

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<sup>13</sup>From Table 4 it is evident that portfolio equity flows to SSA were negligible up to 1994 (also relative to FDI). For the six Swedish program countries that we have data for, it is seen from Table 5, that portfolio equity flows were zero in all countries except for Zimbabwe in 1994. Net debt flows to SSA (including e.g. commercial bank lending and debt repayment), were negative for all evaluated years except 1994 (Table 4). The same applies to most of the program countries, evaluated in 1994 (Table 5). Hence, FDI have almost entirely made up the inflow of private capital to SSA up to 1994, and the same applies to majority of the program countries we have data on.

*Balance of payment effects from MNE activity*

Against the background of shortages of foreign exchange in the majority of SSA countries, the direct effect of foreign affiliates on the balance of payments (BOP) needs to be evaluated.<sup>14</sup> Will the foreign activities of MNEs improve or worsen the BOP of host countries? On the positive side, from the perspective of the host country, we have inflows of foreign capital to start up or expand existing operations; export revenues if the foreign affiliates are export-oriented or contributes indirectly to exports; and savings from imports from import-substituting activities. On the negative side, we have remittance of profits, fees and royalty payments to parent companies; imports of inputs, capital goods and services, and transfers of salaries by expatriates.

However, indirect and more long term effects on BOP from MNE activity can be more important, e.g. the supply of better and/or cheaper goods and services to domestic export firms; and foreign affiliates may improve the competitiveness of the host country's exports. On average, it has been found that export oriented affiliates have a positive effect on BOP, while import-substituting affiliates contribute negatively, because the savings of imports has been offset by imports of inputs and other outflows of foreign exchange.<sup>15</sup>

In Table 6 data are provided on some Swedish program countries. In the latest period it is seen that the net transfer (defined as FDI inflows minus profit remittances) to *Angola*, *Namibia* and *Zambia* (FDI in extraction and exports of minerals) was positive, while the net transfer to *Kenya* and *Zimbabwe* (FDI largely in import substituting activities) was negative. From the table it is also seen that the BOP impact of FDI have improved over time considering the SSA average; negative sign during 1981-85, and positive sign, and increasing value, of net transfer for 1986-90 and 1991-93, respectively.<sup>16</sup>

It should be remembered that this improvement occurred at the same time as many SSA countries relaxed their policy with regards to profit remittances, access to foreign exchange and imported inputs. Hence, contrary to what some countries feared, the liberalization with respect to foreign exchange, appear to have improved, or at least not worsened, BOP. Possibly foreign

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<sup>14</sup>This is in addition to the BOP problems related to exchange rate appreciation that may be resulting from any kind of capital inflow, mentioned above.

<sup>15</sup>It is difficult to assess the net effect of foreign affiliate-activity on balance of payments of SSA countries as systematic data separating foreign versus domestic ownership of firms is lacking.

<sup>16</sup>Since technical services and other intra-firm payments are not included in our measure "net transfer", this measure may in some cases only give a partial picture.

affiliates have responded positively in terms of e.g. higher efficiency and increased export orientation.

### *Volatility*

Financial deregulation increases the volatility of international capital flows, since the removal of different restrictions allows capital to move easier between countries in response to different rates of return. A high volatility may create problems for poor countries to establish or maintain macroeconomic stability. An appreciation of the real exchange rate following inflows of foreign exchange has been a problem in e.g. *Kenya, Tanzania* and *Uganda*.<sup>17</sup> Another problem is high interest rates as a result of central banks attempting to sterilize inflows.

The volatility is to a large extent attributed to portfolio equity flows and short term commercial bank loans, and to a lesser extent long term FDI. Hence, the problems of volatility should be a less severe issue for SSA, since portfolio and commercial bank flows are small, both in absolute and relative terms (Table 4). Furthermore, overall private inflows relative to GNP is much lower in SSA compared with other regions, indicating that the link to international capital markets is still limited.<sup>18</sup> In particular this applies to some of the Swedish program countries (see Table 5 evaluating the six countries for which data was available), where portfolio flows were zero in 1994 except for Zimbabwe, and private net debt flows (including net commercial bank lending) were negative the same year for all countries except Angola.<sup>19</sup> Long term FDI dominated the overall net private inflows to the six Swedish program countries in question.

Even if volatility does increase in response to deregulation of financial markets, this adverse effect may still be outweighed by the potentially positive effects related to improvements in the functioning of financial markets resulting from deregulation. Numerous empirical studies have established a positive relationship between financial sector development and economic growth, although the direction of causation may be debated. In any case, the improvement of the

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<sup>17</sup>The risk of rising volatility is exemplified by the Mexican peso crisis. However, it is not directly appropriate to compare the representative SSA country with Mexico, which has inflows of a completely different magnitude, and is linked to international markets to a much larger extent. The problems in Mexico were much related to the abrupt reversal of the short term capital inflows from abroad, and to a lesser extent long term FDI.

<sup>18</sup>Private capital net flow as share of GNP was 0.8 percent for SSA over the period 1990-93, 3.7 percent for East Asia and the Pacific, and 2.5 percent for Latin America and the Caribbean (World Bank, 1994).

<sup>19</sup>The positive figure for Angola may be partly explained by the fact that the country has not been able to repay private debts.



functioning of financial markets is important in SSA, which has lagged behind other regions in reform. On the positive side, we should not forget the much needed inflows of capital to SSA countries, in view of their low levels of domestic investments and savings. Hence, in a world of high capital mobility it is far from clear whether restrictive policies with respect to capital inflows are capable of reducing possible adverse macroeconomic effects.<sup>20</sup> Such policies also entail costs in themselves, and their effectiveness is limited to a relatively short time.

### **Box 3. Lessons from managing the macroeconomic impact of capital inflows**

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Two countries that have been successful in managing massive capital inflows in relation to the macro economy are Chile and Malaysia. They (i) implemented a comprehensive policy package and did not rely on a single instrument, (ii) at the outset of the surge of inflows, they reacted by treating the inflows as temporary and resisted an appreciation of the real exchange rate, and the foreign exchange inflows were sterilized, (iii) as the inflows persisted, sterilization efforts were cut back, and the domestic currency allowed to appreciate, and (iv) fiscal policy was tightened in order to moderate real appreciation and prevent the economy to overheat.

A strategy used by Portugal and Spain, was to require foreign investors to deposit a certain amount of funds at a central bank account under a period, at low or no interest.

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Source: Calvo *et al.*, (1996).

#### *Economic growth*

A number of econometric studies have investigated the relationship between economic growth at the aggregate level and inward FDI. On the whole, the results suggest a positive relationship, although with some mixed evidence for countries with different level of development. However, it is difficult to assess the direction of causation. Probably we have a two-way relationship, with FDI influencing growth on the one hand, and growth having a positive impact on FDI inflows on the other hand. The positive relationship at the aggregate level may be attributed to increased investments and employment by foreign firms, as well as to spillovers from foreign firms to the domestic economy, as discussed above.

Borensztein *et al.*, (1995), utilizes data on FDI flows from industrial countries to 69 developing countries over the last two decades. Their results suggest that FDI contributes relatively more to growth than domestic investment, although the higher effect of FDI on growth

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<sup>20</sup>The experience from the restrictive legislation in Mexico during the 1970s, exemplifies this critical view.

holds only when the host country has a minimum level of educational attainment.<sup>21</sup> This suggests that countries must have a certain "receiver competence" in order to gain from spillovers and other benefits related to FDI. In countries with very low educational attainment, FDI projects are likely to become "enclaves" relative to an otherwise backward domestic economy. The results in Blomström, *et al.* (1994), analyzing a large number of developing countries, point in the same direction.

The relationship between FDI and growth also appears to depend on the trade orientation of the host country. Balasubramanyam and Sapsford (1996), distinguish between developing countries that are either "export promoting" or "import substituting" in their trade policy regime. The positive relationship between FDI and growth is only confirmed in the case of export promoting host countries. Hence, in order to benefit from FDI it may be important to have an outward oriented policy regime. FDI lured by high import tariffs can therefore be expected to be less beneficial to the host country in terms of growth.

Most and Van Den Berg (1996), distinguish between growth effects of different source of investment financing in a sample of 11 SSA countries. For the whole group of countries, the evidence is inconclusive with respect to differences between foreign aid, FDI and domestic savings. Considering the Swedish program countries included in their study, FDI was found to have a positive impact on growth in *Kenya*, but not in *Zambia* and *Botswana*. The authors argue that foreign investments in the latter two countries were largely in mining, which can be "enclaves" in relation to the domestic economy, although this may not always be the case (see Box 2 on Botswana).

In Box 4 below, some information about recent growth in SSA is provided. As no empirical studies have systematically analyzed SSA countries separately, we do not know what is the contribution of the increased FDI and other private capital inflows on the improved growth rate, but it is likely that capital inflows have contributed positively.

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<sup>21</sup>No higher growth effect of domestic investment was found in countries with a high level of educational attainment.

#### **Box 4. Growth trends in Sub-Saharan Africa**

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According to the most recent available estimates, growth in SSA appears to have picked up to 3.5-4 percent in 1995. If confirmed, this would represent the highest growth so far in the 1990s (growth in 1991-94 averaged only 0.7 percent). The 1995 figures also indicate a positive GDP/capital growth for the first time since 1989. Growth also appears to have been more widespread, exceeding 3 percent for 1995 in nearly thirty SSA countries. High commodity prices contributed to the positive development in e.g. *Kenya*, *Tanzania* and *Uganda*. Output growth for the SSA region over the next ten year period is anticipated to average 3.8 percent (4.2 percent if we exclude South Africa and Nigeria). This can be compared with an average of 1.7 percent over the period 1986-95.

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*Source:* World Bank, (1996b).

### **3. Determinants of inward FDI to developing countries**

Even if the majority of SSA countries have recently improved their regulatory frameworks relating to FDI, and provided various incentives aiming to attract FDI, as will be documented in this section, these efforts have not yet led to any substantial FDI inflows. Of course, the response by investors to deregulation and incentives takes time, and may not yet have materialized. However, there are still a number of crucial conditions for FDI lacking in the region. In an international perspective, Africa as a whole does not compare favorably to foreign investors. Additional incentives, for example, can therefore only be expected to have limited effect on FDI inflows.

This view is supported by study of the locational choice by US firms in a large number of developing and developed countries (Wheeler and Mody, 1992). They find that short run incentives may be costly for the host countries, and have little impact on FDI inflows. What has a much greater impact, according to their study, are rather a well functioning infrastructure and efficient domestic suppliers.

In this section, we *first* review the changes in FDI regulation and incentives that have taken place in SSA countries. *Second*, crucial host country ("pull") factors relating to FDI that are lacking in many SSA countries are identified. These are major bottlenecks that still hold back FDI and other private capital inflows to the SSA region. *Third*, the role of structural adjustment programs is discussed. *Finally*, in more general terms, we look at some ("push") factors at the international level that may lie behind the recent increase in private flows to developing countries.

### 3.1. Regulatory framework and incentives

The majority of African countries are keenly interested in receiving FDI and other private capital inflows, which is in sharp contrast to the situation in the 1960s and 1970s when most governments were hostile towards foreign companies. African countries have during the 1980s and 1990s increasingly adopted national regulatory frameworks conducive to FDI. For instance, countries like *Ethiopia* and *Mozambique*, which were previously very restrictive, have introduced new legislation offering a range of guarantees and opportunities to foreign investors. Countries that were already regarded as relatively open to FDI, like *Kenya* and *Zimbabwe*, have revised their regulatory frameworks to become more attractive. While a widespread reform process is taking place, there are considerable variance across countries, and further deregulation is needed.

Of course, deregulation is not an objective in itself, and should not be pursued if it is not expected to lead to a more efficient solution, or if it clearly against national interests with respect to e.g. control of some strategic natural resources or environmental aspects. If e.g. deregulation leads to e.g. a foreign private monopoly instead of a public one, this may not be an improvement. However, in the current report, we are concerned with deregulation that is aimed at improving the long term efficiency and allocation in the economy.

#### *Ownership regulations*

Restrictions regarding foreign ownership were common in Africa in the 1960s and 1970s. The legislation limited foreign ownership to a percentage of the equity in any enterprise. Generally, these restrictions have been revised or abolished, but some countries maintain restrictions for key industries of national interest, such as petroleum and minerals. However, some countries, e.g. *Kenya*, *Uganda*, *Tanzania* and *Zambia*, have recently been moving away from the mandatory requirement of majority equity by the government in mineral ventures. Restrictions on foreign ownership were often accompanied by the promotion of joint-ventures, implying that the national partner held at least 51 percent of equity. The emphasis on joint-ventures has also been phased out in most countries, or that they are at least no longer required.<sup>22</sup> One explanation is the limited success of joint-ventures to promote more rapid technology transfer or the transfer of the best practice technologies, which were the major motivations behind promotions of joint-ventures

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<sup>22</sup>Like the 1990 Foreign Investment Act in *Namibia*, most new legislation only encourages joint-ventures (UNCTAD, 1995a). Furthermore, the encouragement is mainly for joint-ventures between private domestic firms and foreign investors. Earlier the emphasis was on joint ventures between state-owned firms and foreign investors.

in the first place.

### *Entry requirements*

A majority of countries still maintain requirements that the government must approve new FDI projects.<sup>23</sup> Proposed investments have to meet a number of criteria. Recently, however, reforms are taking place in this area. For example, in *Namibia*, there is no approval process, and foreign investors receive national treatment according to the law. In *Mozambique* and *Eritrea*, there are no required approval processes for investments, but foreign investors must go through an approval process to benefit from tax concessions. In addition to the adverse effect that complicated approval processes may have on FDI inflows, such processes are also a burden to countries' bureaucracies and a source for corruption. Some countries have transformed their investment authorities, whose task was previously to control capital inflows, into *investment promotion organizations*: one example is the Zimbabwe Investment Center.

### *Foreign exchange controls*

As a result of foreign exchange shortages during the 1970s and 80s, many African countries imposed controls on profit remittances and other capital outflows. However, governments appear to have recognized the disincentive these controls have on FDI. The solution adopted in many countries has been to guarantee foreign firms to repatriate capital and profits, hence exempting them from the otherwise restrictive foreign exchange regimes. New schemes in e.g. *Zambia* and *Zimbabwe* allow exporting firms (MNEs as well as domestic firms) to have direct access to all or parts of their foreign exchange earned through exports.

### *Fiscal incentives*

A characteristic of the FDI policies in the 1980s was the provision of fiscal incentives to foreign investors, including lower corporate taxes and import duties. Tax holidays for five to ten years are widely available.<sup>24</sup> Different host countries set different priorities when it comes to incentives. *Kenya*, for instance, grant special incentives for investors in lesser developed regions

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<sup>23</sup>This especially applies to petroleum and minerals in the ground, which are owned by the state in most countries. No one can prospect, mine and produce them without a license.

<sup>24</sup>In some countries the incentives have been negotiable; for example, Tanzania's Investment Promotion Act of 1990 provides for foreign firms to negotiate tax concessions individually (UNCTAD, 1995a).

in the country. The most favorable incentives are generally provided to exporters. Export processing zones (EPZ), offering a package of fiscal incentives and infrastructure, have only had marginal impact in SSA in attracting FDI, with the possible exception of Botswana and Mauritius.<sup>25</sup>

A number of SSA countries have recently started to examine their incentive schemes. Clearly, the effectiveness of the incentives can be questioned in view of the low levels of FDI inflows. The limited impact of incentives on FDI may either be an indication that such incentives have no effect on FDI, that the incentive schemes are not rightly designed, or that it is too early to evaluate the impact on FDI. Furthermore, specific incentives to attract FDI to certain strategic sectors may actually introduce distortions in the economy. If, for example, FDI is attracted to a country by protecting some sector from import competition, the resulting FDI project may not be an efficient one, as discussed earlier (see e.g. Balasubramanyam and Sapsford, 1996). Such FDI may only respond to profit opportunities created by distorted markets.

#### *International regulatory framework*

Developing countries can also conclude bilateral investment treaties (BIT) with capital exporting countries, in an attempt to attract foreign investments. BITs prescribe equitable treatment of foreign investment projects, as well as national and most-favored-nation treatment. By early 1995, close to 250 such treaties were signed by countries in overall Africa. As shown in Table 7, the Swedish program countries have not yet been particularly active with BITs, with the exception of South Africa. As most of the treaties are quite recently concluded, it is not yet possible to evaluate their effect on FDI inflows. The BITs are often supplemented by multilateral arrangements.<sup>26</sup>

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<sup>25</sup>The EPZ in *Botswana*, had a total of 13.000 employees in 1990, and 7 EPZs in Mauritius had a total of 50.000 employees (UNCTAD, 1994). However, Mauritius is an economy with little in common with the rest of SSA. Despite the limited success of EPZ, some countries, e.g. *Eritrea*, *Namibia* and *Zimbabwe*, are still considering EPZs as a policy option (UNCTAD, 1995a).

<sup>26</sup>Two conventions widely accepted by African countries are; (i) the International Convention on the Settlement of Investment Disputes between States and Nationals of other States (which provides a system for resolution of investment disputes), and (ii) the Convention establishing the Multilateral Investment Guarantee Agency, MIGA (which guarantees foreign investors insurance coverage against such non-commercial risks as nationalization, armed conflict or internal disorder). Adherence to MIGA is considered a signal that governments cooperate with foreign investors. By early 1995, 36 African countries were members of MIGA, and another 5 in the process of becoming members. All of the Swedish program countries in SSA are members of MIGA (UNCTAD, 1995a).

### 3.2. Missing "pull" factors that hold back capital inflows to SSA

A number of factors make the investment climate for domestic as well as foreign firm less favorable in Africa compared with other developing regions.

#### *Institutions, legislation and financial sector*

An inadequate institutional, legislative and financial infrastructure characterize many SSA countries. More generally a slow progress in introducing market and private sector oriented economic reforms. A number of studies have also shown that fiscal incentives provided in incentive codes are not by themselves enough to attract FDI, if the business climate is not otherwise favorable. If, for example, the company laws, banking and insurance laws, and contract law are not conducive in doing business, fiscal incentives may be useless. There is a general need in SSA to improve the whole business related regulatory framework, and to provide an attractive investment climate that is all-embracing.

#### *Infrastructure*

Poor and in some cases deteriorating physical infrastructure. In addition, some countries are land-locked lacking deep water harbors. Moreover, the road, railway and airport systems are in many cases bottlenecks in the economy. The same applies to telephone systems and power supply. The latter constraints are especially severe, since the activities of MNEs and international trade in general are dependent on modern telecommunication.

#### *Productivity, skills and education*

The productivity of the labor force is low, despite low wages. This is mainly attributed to the relatively low skill level of the work force, and the generally old capital stock. According to Odle (1996), one problem is that there is still in many countries too much emphasis on formal training of the classical colonial mode, rather than training in trade and industry. Overall, the cost of production in SSA is high compared with other developing regions. For example, by the mid-1980s cost of production in SSA was sometimes twice the cost of low income countries in Asia. This makes SSA a less attractive location for efficiency seeking FDI.<sup>27</sup>

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<sup>27</sup>Managers of a few foreign affiliates of Swedish MNEs located in *Zimbabwe*, complained about the limited availability of skilled workers, and that locally produced products in many cases did not meet international quality requirements, making them hard to export (Braunerhjelm and Fors, 1995).

### *Small domestic markets*

Markets in SSA countries are typically very small, and, hence, does not attract market seeking FDI to a great extent.<sup>28</sup> Regional integration efforts have so far been inefficient in terms of creating larger economic areas or increasing intra-regional trade, although integration is likely to have future potential. Slower growth rates of GDP than other regions also imply that the market size does not increase. In addition, with low GDP per capita the purchasing power of African consumers is low, making market seeking FDI less relevant, despite large populations in some countries.

### *Privatization and debt-equity swaps*

One important reason why SSA has stayed behind other regions in attracting FDI is that it generally lacked what was the driving force of FDI inflows in Latin America and Eastern Europe in recent years; namely FDI linked to privatization and debt-equity swaps.<sup>29</sup> Both of these instruments subsidize FDI to some extent (Sader, 1993).

African countries have recently increased their efforts in privatizing government assets, but to date this has mainly involved small scale privatization with low asset values. With the exception of some large export-oriented mining companies, such as Zambia Consolidated Copper Mines, the privatization programs have had limited impact on FDI inflows. Furthermore, the assets to be privatized were not always made available to foreign investors.<sup>30</sup> Privatization programs in SSA accounted for only slightly more than one percent of FDI inflows during 1988-92 (Sader, 1993).<sup>31</sup>

Debt-equity swaps is a process by which a debt instrument of a debtor country, denominated in foreign exchange, is converted into an equity investment in that country. Hence,

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<sup>28</sup>The market seeking motive is a major determinant of inward FDI, both in developing and developed host countries (see e.g. Caves, 1996).

<sup>29</sup>Privatization and debt equity swaps contributed to around one quarter of all FDI inflows to Latin America during the period 1988-93. In Central and Eastern Europe privatization accounted for 43 percent of the FDI inflows in the same period (UNCTAD, 1995a).

<sup>30</sup>For example, in the Ugandan sugar industry assets were given back without cost to their former owners.

<sup>31</sup>Although insignificant in value, it is interesting to note that some privatization in *Mozambique* was related to FDI, including South African firms in the fishing industry and beverages, and Zimbabwean firms in beverages (Sader, 1993). According to Sader, no other privatizations related to FDI were identified in any of the other Swedish program countries in SSA, during the period 1988-92.



no direct net capital inflow takes place, but a debt reduction may over time make the country more attractive for FDI. In SSA, debt-equity swaps have been limited in value, and mainly used in countries with a large proportion of commercial debt (Nigeria), but less so in countries burdened by official debt.

#### *Debt overhang and foreign exchange shortages*

A large debt overhang, which is the reality for most SSA countries, lead to expectations about higher taxation of future incomes, to finance interest and debt repayment. Some authors argue that debt relief are among the potentially most important approaches for raising net capital inflows to Sub-Saharan Africa (e.g. Ndulu, 1994). Furthermore, heavy indebtedness leads to a lower investor confidence for a country. As part of the debt problem, numerous African countries also suffer from foreign exchange shortages. These shortages make it difficult, at least in the short run, to guarantee that FDI related income can be transferred out of the country, which is crucial to a favorable investment climate.

#### *Political instability*

Civil war, political crisis and natural disasters have been more common in the SSA region. Examples from the Swedish program countries are; *Angola, Eritrea, Ethiopia, Mozambique* (civil wars), and *Zimbabwe* (drought). The situation have, however, recently improved in some of these countries.

### **3.3. Structural adjustment programs**

The World Bank and the IMF have imposed structural adjustment programs on most SSA countries. The success in implementing these programs have varied considerably between countries, but on the whole the SSA region has moved slowly in the direction of more liberalized economies, including more reliance on market forces, international trade and the private sector, as well as an improved macro economy. The payoffs of the programs come with a long lag, and in the majority of SSA countries the impact on growth is yet to be seen (World Bank, 1994), although the most recent growth figures gives a more optimistic picture (Box 4).

What is then the effect of these programs on FDI? For investors already established, this much depends on if they are operating in import substitution or exporting activities. For MNEs

engaged in import substitution, increased foreign competition as a result of structural adjustment programs, may, of course, have short term adverse effects. For example, the foreign and domestic firms in the automobile industry in *Kenya* or in food processing in *Zambia*, producing entirely for the domestic market, have been negatively affected by lowered import tariffs. This has resulted in reductions in employment and capacity utilization. In the longer run, however, MNEs in some import substitution industries should be able to respond to the increased competition by improving efficiency, and become competitive.<sup>32</sup> On the other hand, FDI in exporting sectors, stand to benefit from liberalization and opening of markets both in the short and long run, i.e. through access to imported inputs and foreign exchange, as well as lower valued domestic currencies, and generally a more favorable climate for exporters compared with the situation before liberalization.

### 3.4. "Push" factors at the international level

During the early 1990s, there was a sustained decline of the interest rate in the industrial countries, which pushed capital to new markets in developing countries in e.g. Asia and Latin America, to seek higher returns.<sup>33</sup> In the aggregate, the role of foreign interest rates as a push factor driving capital inflows and determining their magnitude, is well established (Fernández-Arias and Montiel, 1996). Interest rate differentials especially have influence on short term portfolio equity flows and commercial bank lending. FDI flows, on the other hand, are mainly determined by other factors than interest rate differentials (Caves, 1996).

The recessions in the early 1990s in the US, Japan and most countries of Europe, also made profit opportunities in developing countries relatively more attractive (Calvo *et al.*, 1996). Capital flows to developing countries have been pointed out as a way for capital exporting countries to achieve a better international diversification of their portfolios, and to provide support for pensions funds and retirement accounts into the next century (Calvo *et al.*, 1996). To what extent such funds will invest in Africa in the future, is difficult to assess, but investment is already taking place in other "emerging markets" such as Latin America.

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<sup>32</sup>The example of the import substituting automobile industry in Latin America indicates that foreign affiliates in developing countries are capable of restructuring their operations when exposed to external changes (UNCTAD, 1995a)

<sup>33</sup>For example, short term interest rates in the US were declining steadily in the early 1990, and reached their lowest level since the early 1960s by the end of 1992 (Calvo *et al.*, 1996).

#### 4. Recent trends of private capital flows to SSA

Private capital flows, comprising FDI, portfolio equity flows, commercial bank lending and other flows, to developing countries, have been increasing rapidly since the 1980s. In 1994 private long term net resource flows to all developing countries totalled around 160 billion dollars, of which less than 5 billion was attributed to SSA, see Table 5. (and around 5 billion 1995, World Bank, 1996c). However, even if the level is low for SSA, the private net inflows have increased rapidly, as seen from Table 4, and the flows are relatively high if we compare with the region's GDP. In SSA, most of the net private flows are related to FDI: 63 percent in 1994 (and much higher share for earlier years, see Table 4). Portfolio equity flows constituted around 18 percent, and other net debt private flows (including commercial bank lending) around 19 percent, of net private flows to the SSA region in 1994.

In addition to the recorded private capital inflows, there are also private transfers by individuals. It is believed that a large part of these transfers are returning flight capital. In Latin America, for example, the improvement of policies generally lead to a slow-down and then a reversal of capital flight, which in turn had a substantial effect on investments. In 1991, the stock of capital flight from Africa is estimated to have stood at more than 90% of the region's GDP (148 billion dollars), which is e.g. more than five times total gross domestic investment (IFC, 1994). If the confidence in the region improves, and only some of the flight capital returns back to the African region, this could potentially have an enormous impact on investment. Kasekende and Hussein (1997), calculate private capital inflows for some SSA countries, and find that the inflows were considerably higher when including private transfers in the overall inflows. In the case of *Tanzania* and *Uganda*, the private capital inflow figures for 1990-93 were negative without the transfers, but positive and substantial when including private transfers. The authors argue that capital inflows are not correctly measured as they do not include the transfers.

At the same time as private flows have increased dramatically, official development assistance (ODA) has decreased its role (both in absolute and relative terms) in long term net resource flows. This is partly due to aid fatigue in donor countries. In 1994, ODA made up around 23 percent of the net resource flows to developing countries. The remaining 77 percent were private flows (Table 5). Figure 1 clearly illustrates these trends for all developing countries over the period 1990-95.

SSA countries are still considerable more dependent on ODA than other regions, but its

role is decreasing there as well: in 1994, ODA contributed to 77 percent of overall net flows, compared to almost 100 percent in the mid 1980s (and some years in the 1990s as well, Table 4). Hence, these figures point to an increased reliance of private flows in the SSA region, as well as in the developing countries as a group.

#### 4.1. FDI inflows and stocks

##### *General trends*

During the 1990s, FDI has become more important than before, both in absolute and relative terms, in developed as well as developing countries. Propelling the FDI flows were; rapid globalization of production, increasing integration of developing countries in the world economy, and improved policies in the recipient countries. The rapid advance in information technology and international communication has probably also facilitated the increased internationalization. The share of low- and middle-income countries in global FDI inflows increased from 12 percent in 1990 to 38 percent in 1995. FDI flows appear to have responded to reforms in developing countries, reflecting macroeconomic stability and rapid growth. Active privatization programs in many developing countries attracted about 40 billion dollars of FDI from 1990 to 1995.

In East Asia, China was by far the largest recipient of FDI, attracting 38 billion dollars in 1995, followed by Malaysia as a distant second. In 1995, FDI in South Asia grew considerable, e.g. doubling in India, and in the Latin America & Caribbean region the inflow 1995 reached almost 27 billion dollars. The former communist countries in Eastern Europe and Central Asia experienced substantial increases in inflows, reaching 12 billion dollars in 1995.

##### *Sub-Saharan Africa*

FDI inflows to the total SSA region in 1995 were 2.9 billion dollars (Table 1), which constitutes less than three percent of FDI flows to developing countries. Even though a slight decrease in the flow took place between 1994 (3.0 billion dollars) and 1995, it should be noted that the flow has almost increased three-fold compared with 1990 (Table 1). FDI stocks have developed more slowly over time in the case of SSA (from around 25 billion dollars in 1990 to 36 billion in 1995), relative to the developing country average (Table 1, figures in parenthesis).<sup>34</sup>

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<sup>34</sup>The influence of MNEs in SSA countries goes often well beyond the equity investments captured in FDI data. MNEs are often involved in non-equity arrangements such as management contracts, technical assistance agreements, technology transfer agreements and technology licensing. In some larger SSA countries, such as Nigeria, non-equity

Because SSA is a small region in economic terms compared to e.g. Asia or Latin America, it is, however, important not to put too much emphasis on the absolute dollar FDI flows or stocks. Therefore, relative measures are more appropriate to assess the impact and future potential of inward FDI. From Table 2 it is evident that the share of FDI inflows to gross fixed capital formation is substantially higher in SSA compared with the developing country average. Hence, even small absolute FDI inflows may be crucial to stimulate aggregate investments and growth in a situation when domestic investments are limited, as in many SSA countries. The relative importance of FDI in capital formation has also increased markedly over time; from around 4 percent in 1990 to over 11 percent in 1994.

A similar story emerges when inward FDI stock is related to the size of the economy (measured by GDP). From Table 3, we observe that FDI relative to GDP is considerable higher in SSA compared with other developing regions, and we can also note a doubling in the share of FDI stock in GDP between 1985 and 1994.<sup>35</sup> Below we discuss in some more detail inward FDI in selected countries.

#### *Swedish program countries in SSA*

The FDI inflow to Swedish program countries in SSA in 1995 was 719 million dollars (excluding South Africa). This constitutes approximately one quarter of the FDI inflow to overall SSA (Table 1). Other major recipient countries in SSA were petroleum exporting countries such as Nigeria (1.340 million dollars 1995), Cameroon and Gabon, and the resource rich Ghana (UNCTAD, 1996). *South Africa* received limited FDI inflows: in 1995 only 4 million dollars. Negative inflows (divestment) were recorded in the 1980s up to 1993 during the apartheid period. It is possible that a shift has occurred after 1993, but it is too early to evaluate this (Table 1). However, it should be noted that the FDI stocks are large in South Africa, due to earlier inflows before the boycott: the stock in 1995 was 11 billion dollars, to be compared with the overall SSA stock of 36 billion dollars (excluding South Africa).

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forms play as important role as equity forms (UNCTAD, 1995a). In the vast majority of management contracts identified in Swedish program countries in SSA, the operator was a foreign company (Braunerhjelm and Fors, 1996).

<sup>35</sup>A third relative measure is the share of FDI in total private foreign inflows, which was 63 percent for SSA in 1994, compared with 50 percent for all developing countries (Table 4). Hence, the relative importance of FDI as a source of private foreign capital is higher in SSA. Sharp increases in portfolio equity flows to other regions than SSA, of course, influence the relative importance of FDI. Portfolio flows to SSA is still in its infancy.

In Tables 1, 2 and 3 figures for the separate program countries are also reported. The largest recipient within this group was *Angola*, with a FDI inflow of 400 million dollars in 1995, largely attributed to resource extraction. Over half of gross fixed capital formation in Angola is related to FDI, although over time an irregular pattern is observed, due to the unstable political situation and civil war. In 1994 the share of inward FDI stock to GDP in Angola was as much as 30 percent. This high relative measure is, of course, a reflection of the high proportion of oil and other mineral extraction in the country's GDP. The second largest recipient in the Swedish group is *Botswana*, with a FDI inflow of 70 million dollars in 1995.<sup>36</sup> The third largest recipient country was *Zambia* with 66 million dollars, largely in copper and other mineral extraction.

In terms of inflows, *Kenya* (20 million dollars of FDI in 1995), *Mozambique* (36 million dollars), *Namibia* (45 million dollars), *Tanzania* (27 million dollars), and *Zimbabwe* (40 million dollars), fall in the middle of the Swedish program countries. In the case of Mozambique, a recent article in *The Economist* (1997), indicates much higher inflows for 1996, and many new FDI projects in the pipeline, which if they materialize would dwarf earlier inflows to the country. Finally, FDI inflows were modest in *Ethiopia*, *Guinea-Bissau* and *Uganda*, both in absolute and relative terms. Despite the low levels, Uganda, however, exhibit a promising trend over time, which may very well continue in view of the country's much improved overall economic and political situation. Preliminary figures for 1996, also point to a substantial increase in FDI inflows to Uganda.

In summary, FDI inflows have been increasing in most of the program countries in the last couple of years (Angola, Kenya, Mozambique, Namibia, Uganda, Tanzania, Zambia, Zimbabwe, and South Africa). Even if the flows are minor compared with other regions, this indicates a potential for FDI in the program countries for the future.<sup>37</sup> In section 5 we discuss the future potential of FDI in some more detail.

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<sup>36</sup>Botswana has exhibited large changes over time, including divestment during certain years. Botswana is considered a "mature" FDI recipient, where inflows have recently plateaued (UNCTAD, 1995a).

<sup>37</sup>The development of the relative FDI measures are more mixed over time for the program countries. If FDI flows increase, at the same time as the relative FDI measure decreases, this means that either domestic capital formation is increasing more, or that GDP has increased in the same period.

*Source countries of FDI to Africa*<sup>38</sup>

The largest source countries in terms of inward FDI stocks in SSA are (in descending order); United Kingdom, United States, France, Italy, Netherlands, Switzerland and Germany (Table 8). In the case of United Kingdom and France, the old colonial ties are important. More recently, Belgium is beginning to emerge as an important investing country. The United States, is the second largest investor in Africa. The US share of the total inward stock was 25 percent in 1993. South Africa is also a major investor in the region, and it is likely that its role will increase over time (see section 6 for further details). With regards to Japan, it should be noted that Table 8 gives a rather misleading picture as South Africa is included in the figures, and since flags of convenience in Liberia make up the most of the Japanese FDI stock.<sup>39</sup> Malaysia and other Asian countries have, however, recently been increasing their investments in the region.<sup>40</sup>

Sweden, finally, is a negligible investor in Africa, which is probably explained by the lack of colonial, or other historical and cultural links to the region. In 1994, for example, the sales volume of Swedish owned affiliates located in the SSA program countries was only 29 million SEK, to be compared with 403 billion SEK in sales for Swedish owned affiliates world-wide (Braunerhjelm and Fors, 1996). The sales of the Swedish affiliates located in the program countries have actually decreased since the 1970s.

#### **4.2. Portfolio equity flows and investment funds**

Portfolio equity flows has increased rapidly over time to developing countries, especially Latin America and Asia. However, these flows are still small to SSA countries. As seen from Table 5, the portfolio equity flows to SSA totalled 860 million dollars in 1994, compared with 35 billion for all developing countries.<sup>41</sup> Preliminary figures for 1995, indicate that portfolio flows to SSA

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<sup>38</sup>The figures on source countries refers to all of Africa, i.e. SSA and North Africa, but excluding South Africa.

<sup>39</sup>Africa accounted for less than 0.2 percent of Japan's FDI stock world-wide as of March 1996. Japanese trading companies, which have played a major role in initiating and organizing Japanese FDI abroad, are far less represented in Africa than in other regions (UNCTAD, 1996).

<sup>40</sup>Malaysia has large investments in Nigeria, and became the fourth largest investor in South Africa when the Malaysian national oil company Petronas purchased 30 percent of the shares in the South African Engen Company. Another Asian example is Daewoo of South Korea, which are involved in large projects in Nigeria (Månadens Affärer, 1997).

<sup>41</sup>Out of six Swedish program countries that was possible to evaluate, only *Zimbabwe* recorded portfolio inflows. Actually, in Zimbabwe, portfolio equity flows were greater than FDI in 1994 (Table 5).

decreased in 1995 to 465 million (World Bank, 1996c). But, it should be noted that flows to SSA have increased from virtually nothing to this volume in just a few years.

Since 1994, more than 12 Africa-oriented funds have been set up with a total size of over one billion dollars. Initially, the focus of these funds was South Africa, but the base has been broadening to include a growing number of other countries, e.g. Botswana, Ivory Coast, Ghana, Kenya, Mauritius, Zambia and Zimbabwe. The growing portfolio flows are already perceived to bring important benefits, including improved liquidity, greater incentives for privatization and pressure on policy to improve the financial infrastructure.

#### **4.3. Commercial bank lending**

Private commercial loans, which was the dominant component of private flows to SSA during the commercial bank lending boom of 1977-82, saw a sharp decline following the debt crisis, a brief recovery in the second half of the 1980s, and a subsequent decline so that it has been negative or close to zero for most of the 1980s. Net commercial bank lending to the SSA region was negative for the years 1990 to 1993, but showed a sharp upturn in 1994, although the volume was only around 100 million dollars (World Bank, 1996a).

In part, this is because most African countries have not yet restored their access to international financial markets. Creditworthiness ratings, which have shown a marked improvement during the 1990s in other developing regions, remain on average lower for SSA, and only recently has there been some improvement in ratings. Factors such as political risk, weak growth and export performance, macroeconomic instability and high indebtedness, contribute to the low ratings.

#### **4.4. The role of stock markets**

Stock markets have an important role to play when it comes to facilitate the inflow of FDI and other private foreign capital, and more generally to allocate savings and investments in the economy. Most SSA countries have not established stock markets yet, but there is an ongoing process in many countries either to start up or improve the workings of already existing stock markets. In certain Swedish program countries there has been some progress. *Botswana* and *Kenya*, for example, have sought to deepen their stock markets by increasing the number of listed companies, and *Tanzania*, *Uganda* and *Zambia* are establishing stock markets for the first time.



The Zimbabwe Stock exchange attracted about 12 million dollars from foreign sources during the second half of 1993, causing the industrial index to more than double (UNCTAD, 1995a).

## 5. Potential of FDI in SSA

In spite of the small FDI and other capital flows to SSA countries so far, it may not be correct to perceive the whole region as an unattractive investment location. This report has in various places argued that there seems to be a positive trend going on. Based on a number of determinants of foreign direct investments, UNCTAD (1995b) has evaluated the potential for FDI in Africa at the country and sectoral levels, and generally conclude that this potential is not fully exploited in many countries.

### *Potential at the country level*

On the basis of countries' level of development (measured as GDP per capita) as a determinant of FDI it is concluded that *Angola* and *Namibia* are utilizing their FDI potential, but that this is not the case for *Botswana*, i.e. a higher share of FDI in GDP is expected compared with what is observed in Botswana since this country has a relatively high GDP per capita. On the basis of countries market growth (measured as real growth of GDP) as a determinant of FDI, the UNCTAD evaluation points out that *Namibia* and *Mozambique* are utilizing their FDI potential, but that this is not the case for *Botswana* and *Uganda*, i.e. considering the latter two countries high growth we would expect more FDI.

Some of the weaknesses identified in this report as to why SSA countries have failed to attract FDI and other foreign capital flows, should, be possible to be converted to strengths in reforming countries, since there is an unexploited potential when countries improve their policies and other conditions. For example, a number of countries have just begun substantial privatization programs, in which they target foreign investors as major participants. Such projects have not yet materialized, but are in the pipeline. Most of the Swedish program countries in SSA record a smaller share of FDI in capital formation than the SSA average (Table 2). For instance, *Ethiopia*, *Kenya* and *Uganda* record a share of FDI in capital formation of one percent or less.

### *Potential at the sectoral level*

*Primary sector:* Africa is rich in natural resources, and not surprisingly, more than half of

all FDI is in the primary sector. It is in mining of high-value minerals and petroleum where African countries is particularly prominent as a host to FDI. Despite substantial investments in this sector already, UNCTAD (1995b) argues that there is still unexploited potential. Petroleum reserves are substantial, especially in *Angola* and Nigeria, and exploration has a higher success rate than in other regions. Furthermore, it is widely believed that more petroleum reserves will be found in other, partly unexplored, African countries. *Namibia* has large deposits of uranium. Clearly, MNEs already play an important role in these activities, but it is argued that there is scope for more participation.

*Manufacturing:* The abundance of natural resources give countries some locational advantage regarding certain manufacturing activities, due to the potential to process raw materials close to the source. Odle (1996) argues that there is considerable unexploited potential in some amount of refining of raw materials before exporting, of e.g. petroleum and mining products, as well as within agriculture, fishing and forestry. According to Odle there should be investment opportunities not only in extractive sectors, but also in the agro-industrial sector catering for the domestic and regional basic needs.

*Services:* The UNCTAD report also points to an unexploited potential for FDI in many different services, since the local supply of services is often lacking in SSA countries, and in view of a rising demand for different professional services in the region (e.g. telecommunication, transportation, modern hotels, banks, accounting firms, and business consultants). Recent deregulation within e.g. infrastructure and financial markets have allowed FDI to take place in these previously restricted sectors. The development of the region's infrastructure offers, according to Odle (1996), immense scope for increased FDI. First a privatization strategy (partly targeted at foreign investors) can be followed with respect to the existing stock of state capital in e.g. telephone networks, power supply and transportation. The experiences of privatization within infrastructure in other regions show that secondary rounds of FDI (for upgrading and expanding the infrastructure stock) of a greenfield nature may follow in the post-privatization episode. Certainly some countries have a great unexploited potential in tourism (e.g. *Tanzania* and *Mozambique*), and it is likely that this could attract FDI in various services industries such as hotels.<sup>42</sup>

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<sup>42</sup>Morocco and the Seychelles are examples of countries in Africa that have already benefitted greatly from FDI in tourism.

## 6. South Africa as a growth pole and regional integration

Since most SSA countries are each so small, it is relevant in any development strategy to take into consideration regional integration. A critical element in such a strategy is that one or more countries in the region play a leading role and act as a driving force with respect to trade and cross-border investment (Odle, 1996). Clearly *South Africa* could potentially play that role, and accelerate the creation of a regional production network system.<sup>43</sup> However, the role of South Africa in this process much depends on the country's political and economic stability in the future.

The question is whether FDI can act as an engine of growth in the sub-regional and regional development process in SSA in a similar way that it was the driving force behind the "flying wild geese" pattern of development observed in the last couple of decades in East Asia. In such a process the involved countries pursue an export oriented strategy and the lead economy is the main provider of technology, complementary inputs and markets (initially Japan in East Asia). Learning and imitation by the next ranking countries is an instrumental part of the process.

### Box 5. FDI to and from Mauritius

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An example of "flying wild geese" pattern is provided by recent development in Mauritius, sometimes claimed to be the most successful SSA country. Initially Asian MNEs located textile production to Mauritius, due to e.g. low wages and a good location. As wages have risen over time in Mauritius, textiles companies from Mauritius have themselves started to relocate certain production stages to cheaper wage countries such as Madagascar. At the same time, the Mauritian firms home operations move into higher value-added activities.

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*Source:* Economist (1996).

*First*, South Africa has a potential to attract sizable inflows of FDI. One reason is South Africa's large domestic market, but it is also possible that MNEs may increasingly locate more advanced export production to South Africa to serve the region. The inward FDI stock in South Africa is already sizable, although the flows have been small in recent years (Table 1). One sign that something is going on in South Africa is the number of bilateral investment treaties entered with capital exporting countries in the past few years (Table 7). *Second*, capital and technology rich South Africa should be able to increase its FDI in the region for the purpose of market access.

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<sup>43</sup>The formation of the Euro-Magreb partnership in 1992, in which Algeria, Morocco and Tunisia strengthened their economic relations with the EU, is an example in which the growth pole role can also be played by an outsider to the region (Odle, 1996).

to these countries (instead of exporting from South Africa), and export oriented FDI utilizing neighboring countries cheaper labor and make these countries into export platforms serving the region as well as overseas markets (see below on details on South African FDI in SSA). *Third*, FDI from industrial countries may be attracted to the region in order to serve the large South African market from a neighboring (and cheaper) country.

A large shift in capital flows to *South Africa*, may generate externalities for smaller neighboring countries. These are the so called "contagion" effects. It has, for example, been argued that Chile's and Mexico's re-entry into international capital markets in 1990 made foreign (and domestic) investors more willing to invest in other emerging countries in Latin America (Calvo et al., 1996). Furthermore, it appears that Lesotho and Swaziland have benefitted from their special status of having the same monetary area as South Africa. It is likely that the other neighbors *Zimbabwe*, *Botswana*, *Namibia* and *Mozambique*, will, or have already, benefitted from being close to South Africa, both in terms of FDI inflows from South Africa and from other investing countries choosing to serve the South African market from a neighboring country (examples from Zimbabwe which has lower wages).

#### *South Africa is an investor in the region*

South Africa is a major investor in the region. In 1993, affiliates of South African MNEs located in other African countries had sales of around 38 billion dollars, to be compared with 59 billion dollars in sales for affiliates located in Africa from all source countries (UNCTAD, 1996).<sup>44</sup> Hence, using *foreign affiliate sales* as a measure of foreign activity, South Africa is the largest investor in the region. These very high sales figures should mainly be explained by the foreign affiliates' exports of primary products, and to a lesser extent sales on domestic African markets. South African MNEs operate in e.g. mining, construction, agriculture, food, paper, distributive trade, and finance.<sup>45</sup> In terms of FDI inward stock, it is seen from Table 6, that South Africa ranked number 8 among source countries, with a stock exceeding 900 million dollars 1986 (note

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<sup>44</sup>The sales figures are based on the ten largest (or fewer if data on the ten largest is not available) foreign affiliates in all African countries, in all industries excluding finance and insurance.

<sup>45</sup>In the financial sector, for example, South African banks have made several acquisitions of banking networks elsewhere in southern and eastern Africa (UNCTAD, 1995a).

that the figures for the other source countries are from the early 1990s).<sup>46</sup> In any case, South Africa must be considered a major investor in the region, and, depending on the economic and political development in the country, its role as investor in the SSA region may increase in the future.

## 7. What can SIDA do to promote FDI and other private inflows?

The following four broad areas of involvement by SIDA is recommended. Each one is dealt with in more detail in sections 7.1 to 7.5.

*First*, of highest priority, relating to conditions in host countries, is to improve the business climate, increase privatization, reduce bottlenecks relating to infrastructure, and increase training. All these efforts can be pursued at a rather detailed level, i.e. removing specific bottlenecks relating specifically to a potential FDI inflow (e.g. deregulation of air freight and telecommunication in Zimbabwe).

*Second*, also of high priority, is to assist program countries to take advantage of the linkages to South Africa, and possibly other more advanced SSA countries, as regional growth poles in their efforts to increase capital inflows. Hence, it should be important to promote regional integration if this can increase capital flows from outside source countries or within the region.

*Third*, promotion of Swedish MNEs to invest in program countries. This area may be of lower priority, but could be explored in the future when business conditions in host countries are improved. In this respect, it should be highlighted that Swedish private investments to SSA and other program countries are very small to date.

*Fourth*, SIDA should continue to participate in multilateral efforts, both by providing financial resources, and actively contribute to the policy dialogue.

Finally, it is proposed that SIDA undertakes detailed case studies of FDI in *Botswana* and *Bangladesh*, since these program countries appear to have been relatively successful in taking advantage of FDI inflows.

Needless to say, it is important that SIDA continues to assist countries in improving the workings of the economy, e.g. a stable macro economy, an open trade regime, domestic deregulation, which has a positive impact at a more general level, including inflows of capital.

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<sup>46</sup>It can be discussed which is the best measure of foreign activity in a country. Foreign affiliate sales measures the volume of activity for a certain year, while the FDI stock is the accumulated investments going from the source country to the host country.

### **7.1. Increase the attractiveness of SSA as host countries**

The regulatory framework regarding FDI and other capital inflows have been reformed and improved in recent times in many SSA countries, although there is scope for further reform. Fiscal and other incentives to attract capital inflows have also been provided. However, even though deregulation and incentives are important, these measures do not by themselves seem to have had any major impact on the FDI inflow to SSA countries so far. This report argues that there are several other more general economic conditions that are still lacking in SSA, that act as bottlenecks with respect to capital inflows. It is therefore recommended that SIDA should make an effort to assist program countries to continue to advance in terms of institution building, legislation, financial markets, privatization, infrastructure and training of the work force.

Since Sweden is a small donor country in absolute terms, we argue that SIDA's own efforts should be concentrated to few countries, and in the chosen countries, SIDA should take a broad view, as partial improvements may no have any effect if other bottlenecks remain. If SIDA would be able to contribute to a broad improvement of the investment climate in a few countries, this may lead to real results, at least in these countries. If, on the other hand, too many countries are supported to a lesser extent, we probably get no, or limited. Furthermore, if substantial improvement can be obtained in a few countries, and this results in inflows of capital, these countries may act as sub-regional growth poles and have positive linkage or demonstration effects on neighboring countries.

All of the issues dealt with above are also relevant in the multilateral situation, and here SIDA should more generally participate in assistance to improve the broader framework in a wider group of countries.

#### *Improvement in the business climate*

This includes reform and liberalization of institutional, legislative and financial systems, and implies an increased movement towards a policy regime that generally supports private sector and market orientation. Transaction costs in the economy related to inefficient bureaucracies, corruption and a poor working market economy, deters entry by MNEs. Legislation with regards to contracts, corporate law and ownership are also instrumental in reducing transaction costs and attract foreign investments. The workings of domestic financial markets, including stock markets, are also important for MNEs, even if these bring some foreign capital with them initially.

Reform and improvements of institutions, legislation and the functioning of financial markets, will, of course, also have a positive impact on domestic firms. Efficient domestic firms as e.g. potential suppliers and distributors to MNEs, should also be a crucial factor in attracting investments. In addition, more efficient domestic firms have a greater potential to benefit from spillovers related to FDI.

### *Privatization*

Efforts should be made to increase privatization in the program countries, and specifically target certain state owned assets to foreign investors where applicable. Privatization has been shown to be an important pull factor for FDI in other regions.<sup>47</sup>

### *Development of infrastructure*

Many SSA countries are characterized by a poor physical infrastructure, and some are land locked, and the majority of countries has a disadvantageous location in relation to world markets. This will discourage FDI inflows since MNEs are dependent on imports of inputs, exports of output in the case of export oriented foreign affiliates, distribution within the country, international and domestic telecommunication, and supply of electricity. SIDA should continue to assist program countries to improve the infrastructure, at the domestic, regional as well as international level. If MNEs are not able to efficiently obtain inputs, export or distribute their output, communicate within the country or internationally, this is a major cost for investors. In some cases the issues are about deregulation and privatization of infrastructure, in others about the improvement of the physical infrastructure stock. The privatization of infrastructure can be linked to FDI, as discussed more generally above. MNEs can bring both financial resources and know-how to improve infrastructure and reduce this kind of bottlenecks. Hence, FDI in infrastructure may have a positive influence on FDI in e.g. manufacturing.

### *Education and increased skill of the workforce*

At the overall level the educational of the population is an important determinant of FDI, especially in the case of FDI outside primary sectors. SIDA's efforts in terms of education are

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<sup>47</sup>The Commonwealth Development Corporation of the United Kingdom, has recently set up an investment fund managed by a merchant bank, to target capital flows to privatization projects in developing countries within the Commonwealth

therefore important for inflows of capital, as well as for development in general. More specifically, it is recommended that SIDA assist program countries to enhance more practical skills in industry and trade (including management, accounting and finance), since these kind of skills are often lacking to a higher degree than formal education.

MNEs, as well as domestic firms, have pointed out that it is difficult to recruit workers locally with these more practical skills (see e.g. Braunerhjelm and Fors, 1995, in the case of Zimbabwe). Such training can be provided by institutes or colleges outside the formal educational system, e.g. jointly with industry organization. SIDA should continue to contribute to establish or expand such training institutions, in particular in those fields that are in line with the existing industry structure in the country (e.g. agro-industry, wood and metal working in Zimbabwe). Investments in human capital, should, as some empirical studies indicate, also lead to a stronger relationship between FDI and growth, since FDI projects are less likely to become enclaves in host countries with a higher educational attainment.

## **7.2. Promote FDI through linkages with South Africa and regional integration**

As have been argued in this report, a positive development in South Africa, should potentially attract FDI and other investments, not only to South Africa, but also to neighboring countries. It is also possible that other smaller countries may become growth poles, and have positive external effects on neighboring more backward countries (e.g. the case of Mauritian firms moving production to Madagascar). The issue is how neighboring countries can increase their linkages to the growth poles, and in this way attract more investments. The next question is how SIDA can participate in this process.

The recent emergence of South Africa into the global economy implies that little (if any) efforts in this direction has been pursued by donors. However, it is argued that this could be of great potential as a way to increase FDI inflows to the neighboring countries in southern and eastern Africa. As a first stage it is therefore recommended that SIDA undertakes a detailed study on this issue, e.g. what are the existing linkages in terms of investments between South Africa and neighboring Swedish program countries, and how could these linkages be promoted. The Mauritius-Madagascar link should also be studied.

At the more general level it should be important to promote regional integration. It is likely that regional integration can enhance inward investment, both within the region, and from



countries outside the region. The integration efforts pursued so far by the Southern Africa Development Community (SADC)<sup>48</sup> countries point to a future potential. However, research is needed on the issue of how regional integration (e.g. SADC) influences capital inflows to the region, and investment flows between the countries in the region. In promoting regional integration it is important to take into account possible adverse impacts from integration (e.g. trade diversion), as has been observed in some other regions. It is therefore essential to evaluate the relationship between regional integration and inward investments.

### **7.3. Promote FDI by Swedish firms in SSA countries**

The third area concerns how firms in source countries can be influenced to invest in SSA countries to a greater extent. Swedish FDI or other investments are so far negligible in the program countries, or SSA in general. The most likely explanation is the lack of colonial, and other historical or cultural ties between Sweden and the region.

Although SIDA is already involved in some promotion, both at the bilateral and multilateral level, SIDA should focus its effort in promoting Swedish FDI to program countries. Basically, SIDA's role should be to disseminate information, organize and facilitate meetings and contacts, and "match" investors with investment projects in host countries. As Sweden has limited ties to the region (except for aid), Swedish firms probably lack information and knowledge about opportunities in Africa to a greater degree than firms from other European countries. Hence, Swedish firms may benefit relatively more from promotion.

Let us start by pointing out that the objective of promotion should *not* be to target certain sectors or industries (like in industrial policy). Neither SIDA nor any other institutions or organizations have the capacity to "pick the winners". Nevertheless, it is recommended that promotion efforts are concrete, and that only a few projects are pursued. SIDA could start to do a few pilot projects in one or a few program countries (in areas where both Sweden and the program country have some common advantage). Detailed evaluation of the projects should be undertaken continuously. A number of source countries have promotion programs running, but the efforts have generally been too broad, success so far limited, and little evaluation of their effectiveness has been done. In addition, this kind of FDI promotion appears to have mainly been

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<sup>48</sup>The SADC comprises Angola, Botswana, Lesotho, Malawi, Mozambique, Namibia, Swaziland, Tanzania, Zambia and Zimbabwe.

used in other regions than SSA (Pirnia and Weigel, 1996). More specifically, the following kind of promotion is possible:

(i) Disseminate information about investment opportunities in program countries to potential Swedish investors. Relevant Swedish companies could be contacted directly. This points to a need that SIDA undertakes studies both in Sweden to search for relevant investors (individual MNEs), and in the program countries to locate possible investment opportunities. The latter includes state-owned enterprises and other assets to be privatized in the host countries. The International Finance Corporation (IFC), which is the private lending arm of the World Bank, has as its main task to find viable commercial projects to be co-financed with MNEs.<sup>49</sup>

(ii) Organization of seminars for potential Swedish companies and potential program host countries to inform about legal and financial issues, investment guarantees and insurance.

(iii) Public guarantees provided to the investor by the source country government. This policy instrument has been largely overlooked in the past, but has for instance been an important determinant of German FDI to developing countries. In the case of Germany, the costs of the instrument has so far been low, due to infrequent defaults (Gubitz, 1991). This kind of incentive should be explored more, and may be more efficient than incentives provided in host countries, since fiscal incentives can lead to foregone tax revenues for the host country (at least in the short term). Furthermore, public guarantees by the source country is an instrument that can be controlled by the source country, and that influences incentive structures mainly in the source country. This should be seen against the background of the sometimes problematic impact that aid can have on developing countries' incentive structures.

Finally, it can, of course, be questioned if the promotion of Swedish FDI is the first best policy. What makes Sweden a "better" investor than other countries. However, in a bilateral context, it is difficult for SIDA to work with e.g. German firms. In the multilateral context, SIDA is already participating in this respect, but involving more source countries and host countries.

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<sup>49</sup>According to Pirnia and Weigel (1996), the problem with "match-making" is sometimes that the investors do not feel they "own" the project. Also, it can be argued that private firms should themselves be able to find profitable investment opportunities around the world, especially large firms. However, in the case of Swedish investors, with limited experience in the region, there may be scope that promotion could contribute to small as well as large firms.

#### 7.4. Multilateral efforts

SIDA should continue to participate in the multilateral work, providing financial resources and contribute to the policy dialogue, as a member in e.g. The World Bank, IMF and EU. Here Sweden has the possibility to take part in larger projects it could not handle itself. This applies as well to the cooperation with selected other donor countries for certain projects of "medium" volume. It is, of course, crucial that donor countries coordinate their efforts, and that these are consistent with overall goals. Most of the above issues relating to FDI and other private investments are already pursued in the multilateral programs. Only in a few selected countries can SIDA make any substantial effort alone.

#### *European Union and the Lomé Convention*

Since Sweden is a member of the European Union, SIDA should continue to contribute together with other EU countries in the multilateral effort to promote FDI and other capital flows. To encourage private investment flows and the development of enterprises the fourth Lomé Convention between the European Union (EU) and the African, Caribbean and Pacific (ACP) states prescribes a number of issues.<sup>50</sup> As the current Lomé Convention runs out in the year 2000, SIDA should actively participate in the shaping of the new policy regime towards the ACP countries, and strengthen the cooperation with respect to FDI and other private inflows, as this is an area of increased importance for developing countries.

#### 7.5. Case studies of Botswana and Bangladesh

Finally, it is proposed that SIDA should undertake detailed case studies of two Swedish program countries, namely Botswana and Bangladesh, which have in different ways been successful in taking advantage of FDI inflows. This should yield insights on SIDA's efforts in other program countries. In *Botswana*, FDI has been diversified from initially being only in extractive industries to also include processing of primary products. How can countries make sure that FDI becomes something more than enclaves, with limited spillovers on the domestic economy? In the case o

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<sup>50</sup>These include; (i) promotion of European investment in ACP states by organizing discussions between potential investors and host countries regarding e.g. legal and financial issues, (ii) encourage the flow of information about investment opportunities in ACP countries, by organizing meetings and providing periodic information, (iii) dissemination of information about investment guarantees and insurance, and find ways to reduce the host country risk in ACP countries, (iv) provide assistance to small and medium enterprises in designing and obtaining, equity and loan financing, and (v) strengthen the ACP countries capacity to undertake feasibility studies and the preparation of projects

*Bangladesh*, minor FDI in the clothing industry led to adoption of new technologies (quality control) by the entire domestic industry, that in turn made clothing the country's major export industry. How can a country benefit from inflows of technology and enhance the domestic industry at a larger scale?

and  
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L. 2000  
M. 2000  
F. 2000  
S. 2000  
N. 2000  
A. 2000  
I. 2000  
N. 2000  
S. 2000  
P. 2000

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**Abbreviations**

ACP: African, Caribbean and Pacific countries

BIT: bilateral investment treaty

BOP: balance of payments

EPZ: Export processing zone

FDI: foreign direct investment

MNE: multinational enterprise

ODA: official development assistance

SADC: Southern Africa Development Community

SIDA: Swedish International Development Cooperation Agency

SSA: Sub-Saharan Africa (excluding South Africa)



TABLE 1. Net FDI inflows, and FDI inward stocks (in parenthesis), for regions and selected Sub-Saharan African countries, million dollars

| region/country            | 1984-89<br>(a) | 1990               | 1991   | 1992   | 1993   | 1994               | 1995<br>(b)        |
|---------------------------|----------------|--------------------|--------|--------|--------|--------------------|--------------------|
| Developing countries      | 22.195         | 33.735<br>(341675) | 41.324 | 50.376 | 73.135 | 87.024<br>(593621) | 99.670<br>(693300) |
| Sub-Saharan Africa<br>(c) | 1.468          | 1.137<br>(25.343)  | 1.884  | 1.491  | 1.804  | 2.982<br>(33.300)  | 2.895<br>(36.195)  |
| Angola                    | 172            | -335<br>(1.024)    | 665    | 288    | 302    | 350<br>(2.629)     | 400<br>(3.029)     |
| Botswana                  | 64             | 96<br>(877)        | -8     | -2     | -287   | -48<br>(532)       | 70<br>(602)        |
| Ethiopia                  | 1              | 12<br>(116)        | 1      | 6      | 6      | 7<br>(136)         | 7<br>(143)         |
| Guinea-Bissau             | 1              | 2<br>(8)           | 2      | 6      | -2     | 0<br>(14)          | 1<br>(15)          |
| Kenya                     | 29             | 57<br>(393)        | 19     | 6      | 2      | 4<br>(423)         | 20<br>(443)        |
| Mozambique                | 2              | 9<br>(42)          | 23     | 25     | 30     | 33<br>(153)        | 36<br>(189)        |
| Namibia                   | 2              | 29<br>(2.060)      | 121    | 79     | 32     | 30<br>(2.123)      | 45<br>(2.168)      |
| Uganda                    | -              | -6<br>(4)          | 1      | 3      | 3      | 5<br>(16)          | 7<br>(23)          |
| Un. Rep. of Tanzania      | 1              | -3<br>(11)         | 3      | 12     | 20     | 0<br>(46)          | 27<br>(73)         |
| Zambia                    | 71             | 203<br>(593)       | 34     | 50     | 55     | 60<br>(792)        | 66<br>(858)        |
| Zimbabwe                  | -8             | -12<br>(2.267)     | 3      | 15     | 28     | 35<br>(2.348)      | 40<br>(2.388)      |
| South Africa              | -3             | -5<br>(11.052)     | -8     | -5     | -8     | 6<br>(11.038)      | 4<br>(11.041)      |

Notes: Number in top of cell is FDI inflow, number in parenthesis is FDI inward stock. The stocks are only available for 1990, 1994 and 1995. (a): annual average, (b): estimate, (c): excl. South Africa. Source: UNCTAD (1996).

TABLE 2. Share of net FDI inflows to gross fixed capital formation, regions and selected Sub-Saharan African countries, percentage

| region/country        | 1984-89<br>(a) | 1990  | 1991  | 1992 | 1993  | 1994 |
|-----------------------|----------------|-------|-------|------|-------|------|
| Developing countries  | 2.8            | 3.2   | 4.0   | 4.8  | 6.3   | 7.5  |
| Sub-Saharan Africa(b) | 6.4            | 3.9   | 7.2   | 5.9  | 7.0   | 11.3 |
| Angola                | 31.3           | -52.7 | 107.5 | -    | 48.0  | 55.8 |
| Botswana              | 13.4           | 18.0  | -0.6  | -0.2 | -20.2 | -3.4 |
| Ethiopia              | 0.1            | 1.6   | 0.1   | 2.5  | 0.9   | 1.0  |
| Guinea-Bissau         | 1.4            | 3.5   | 3.3   | 10.0 | -2.6  | -    |
| Kenya                 | 2.1            | 3.2   | 1.2   | 0.5  | 0.2   | 0.3  |
| Mozambique            | 0.4            | 1.1   | 2.6   | 3.2  | 3.2   | 3.3  |
| Namibia               | 1.2            | 6.2   | 34.0  | 14.5 | 6.5   | 5.8  |
| Uganda                | -              | -1.1  | 0.2   | 0.6  | 0.6   | 0.7  |
| Un. Rep. of Tanzania  | 0.1            | -0.2  | 0.3   | 1.1  | 2.0   | -    |
| Zambia                | 28.4           | 40.2  | 8.9   | 14.3 | 26.7  | 19.1 |
| Zimbabwe              | -0.9           | -1.1  | 0.2   | 1.2  | 2.2   | 2.7  |

Notes: Figures for South Africa not available

(a): annual average

(b): excluding South Africa

Source: UNCTAD (1996)

TABLE 3. Share of inward FDI stock to GDP, regions and selected Sub-Saharan African countries, percentage

| region/country        | 1985  | 1990 | 1994 |
|-----------------------|-------|------|------|
| Developing countries  | 7.7   | 8.3  | 12.5 |
| Sub-Saharan Africa(a) | 10.1  | 15.0 | 20.4 |
| Angola                | 11.1  | 12.4 | 30.2 |
| Botswana              | 45.3  | 26.6 | 13.8 |
| Ethiopia              | 2.4   | 1.9  | 2.9  |
| Guinea-Bissau         | 0.8   | 3.3  | 6.0  |
| Kenya                 | 6.0   | 4.6  | 6.1  |
| Mozambique            | 0.7   | 2.9  | 10.6 |
| Namibia               | 151.7 | 89.5 | 73.6 |
| Uganda                | 0.2   | 0.1  | 0.3  |
| Un. Rep. of Tanzania  | 1.1   | 0.3  | 1.3  |
| Zambia                | 4.4   | 15.8 | 23.9 |
| Zimbabwe              | 66.6  | 36.6 | 42.2 |
| South Africa          | 19.8  | 10.4 | 9.1  |

Notes:

(a): excluding South Africa

Source: UNCTAD (1996)

TABLE 4. Aggregate net resource flows to Sub-Saharan Africa (excl. South Africa), 1985-94, billion dollars

| year | Private       |                    |     |                        | Official developmnt assistance and other official transfers |
|------|---------------|--------------------|-----|------------------------|---|
|      | Total private | net debt flows (a) | FDI | portfolio equity flows |   |
| 1985 | 0.0           | -1.0               | 1.0 | 0.0                    | 8.7   |
| 1990 | 0.2           | -0.7               | 0.9 | 0.0                    | 16.9  |
| 1991 | 1.0           | -0.8               | 1.8 | 0.0                    | 15.3  |
| 1992 | 0.3           | -1.3               | 1.5 | 0.1                    | 16.0  |
| 1993 | -0.8          | -2.7               | 1.8 | 0.1                    | 14.3  |
| 1994 | 4.7           | 0.9                | 3.0 | 0.9                    | 15.4  |

Notes: Figures may not add to totals due to rounding. World Bank data and UNCTAD data on FDI are not fully consistent.

(a): including net commercial bank lending.

Source: World Bank (1996a)

TABLE 5. Aggregate net resource flows to developing countries, Sub-Saharan Africa and selected Sub-Saharan African countries, 1994, million dollars

| region/country         | Private        |                    |        |                        | Official development assistance and other official transfers |
|------------------------|----------------|--------------------|--------|------------------------|--|
|                        | Total private  | net debt flows (a) | FDI    | portfolio equity flows |  |
| developing countries   | <b>158.789</b> | 43.775             | 80.120 | 34.894                 | <b>48.614</b>  |
| Sub-Saharan Africa (b) | <b>4.725</b>   | 878                | 2.982  | 860                    | <b>15.411</b>  |
| Angola                 | <b>409</b>     | 59                 | 350    | 0                      | <b>328</b>   |
| Botswana               | <b>-50</b>     | -2                 | -48    | 0                      | <b>32</b>  |
| Ethiopia               | <b>-13</b>     | -20                | 7      | 0                      | <b>853</b>   |
| Kenya                  | <b>-272</b>    | -276               | 4      | 0                      | <b>378</b>   |
| Zambia                 | <b>-4</b>      | -64                | 60     | 0                      | <b>479</b>   |
| Zimbabwe               | <b>-70</b>     | -155               | 35     | 50                     | <b>410</b>   |

Notes: World Bank data and UNCTAD data on FDI are not fully consistent.

(a): including net commercial bank lending.

(b): excluding South Africa

Source: World Bank (1996b)

TABLE 6. Net transfer, defined as: FDI inflows minus profit remittances selected Sub-Saharan African countries, million dollars

| region/country        | 1981-85   | 1986-90 | 1991-93   |
|-----------------------|-----------|---------|-----------|
| Sub-Saharan Africa(a) | -343.2    | 21.1    | 654.7     |
| Angola                | 101.3 (d) | -74.0   | 151.8 (c) |
| Botswana              | -87.4     | -187.3  | -         |
| Kenya                 | -55.6     | -11.2   | -85.1     |
| Namibia               | -         | -       | 24.6 (c)  |
| Un. Rep. of Tanzania  | -         | -23.5   | -         |
| Zambia                | 1.0       | 94.7    | 26.3 (b)  |
| Zimbabwe              | -69.1     | -81.3   | -53.3     |

Notes: Annual averages

(a): excluding South Africa

(b): 1991

(c): 1991-92

(d): 1985

Source: UNCTAD (1995a)

TABLE 7. Bilateral Investment Treaties concluded from January 1994 to June 1996, selected Sub-Saharan African countries

| SSA-country             | signed with  | date   |
|-------------------------|--|--|
| Namibia                 | Germany<br>Switzerland   | Jan 94<br>Aug 94   |
| Uganda                  | Egypt  | Nov 95   |
| United Rep. of Tanzania | United Kingdom   | Jan 94   |
| Zambia                  | Switzerland  | Aug 94   |
| Zimbabwe                | Portugal<br>United Kingdom<br>Germany  | May 94<br>March 95<br>Sept 95  |
| South Africa            | United Kingdom<br>Netherlands<br>Switzerland<br>Korea, Rep. of<br>Germany<br>France<br>Cuba<br>India | Sept 94<br>May 95<br>June 95<br>July 95<br>Sept 95<br>Oct 95<br>Dec 95<br>Feb 96 |

Source: UNCTAD (1996)

TABLE 8. FDI inward stock in Africa, by source country, 1992

| source country<br>(ranked by FDI stock) | FDI inward stock<br>million dollars |
|---|-------------------------------------|
| United Kingdom                          | 6.155                               |
| United States                           | 4.372 (a)                           |
| Japan                                   | 3.308 (a), (b)                      |
| France                                  | 2.524 (c)                           |
| Italy                                   | 1.352                               |
| Netherlands                             | 1.224                               |
| Switzerland                             | 1.217                               |
| South Africa                            | 917 (d)                             |
| Germany                                 | 913                                 |
| Canada                                  | 161                                 |
| Norway                                  | 87                                  |

Notes: Africa refers to SSA and North Africa, but excludes South Africa

(a): 1993

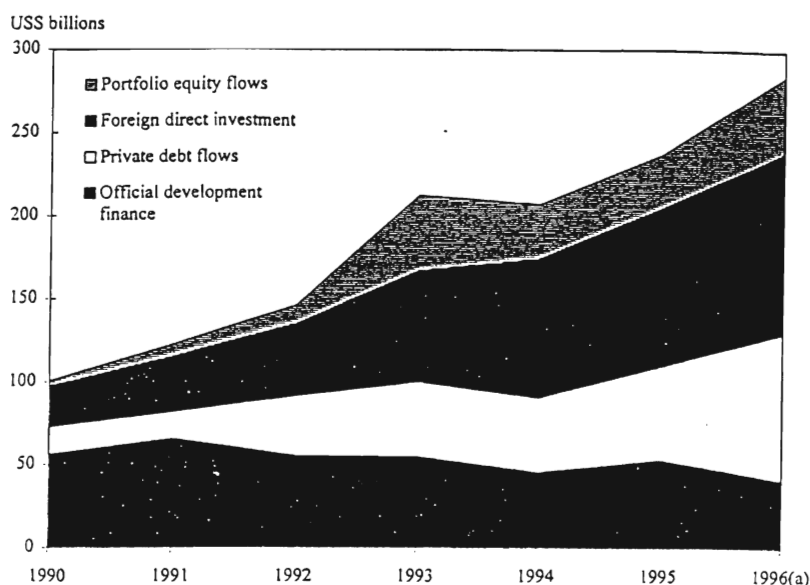
(b): Including South Africa. Liberia (flags of convenience) accounts for most of the Japanese stock.

(c): 1991

(d): 1986

Source: UNCTAD (1995a).

Figure 1 Aggregate net long-term resource flows to developing countries, 1990-96.



(a) Preliminary

Source: World Bank (1997)

Aggregate net long-term resource flows to developing countries, 1990-96

(billions of U.S. dollars)

| Type of flow                 | 1990  | 1991  | 1992  | 1993  | 1994  | 1995  | 1996 <sup>a</sup> |
|------------------------------|-------|-------|-------|-------|-------|-------|-------------------|
| Aggregate net resource flows | 100.6 | 122.5 | 146.0 | 212.0 | 207.0 | 237.2 | 284.6             |
| Official development finance | 56.3  | 65.6  | 55.4  | 55.0  | 45.7  | 53.0  | 40.8              |
| Grants                       | 29.2  | 37.3  | 31.6  | 29.3  | 32.4  | 32.6  | 31.3              |
| Loans                        | 27.1  | 28.3  | 23.9  | 25.7  | 13.2  | 20.4  | 9.5               |
| Bilateral                    | 11.6  | 13.3  | 11.3  | 10.3  | 2.9   | 9.4   | -5.6              |
| Multilateral                 | 15.5  | 15.0  | 12.5  | 15.4  | 10.3  | 11.1  | 15.0              |
| Total private flows          | 44.4  | 56.9  | 90.6  | 157.1 | 161.3 | 184.2 | 243.8             |
| Debt flows                   | 16.6  | 16.2  | 35.9  | 44.9  | 44.9  | 56.6  | 88.6              |
| Commercial banks             | 3.0   | 2.8   | 12.5  | -0.3  | 11.0  | 26.5  | 34.2              |
| Bonds                        | 2.3   | 10.1  | 9.9   | 35.9  | 29.3  | 28.5  | 46.1              |
| Others                       | 11.3  | 3.3   | 13.5  | 9.2   | 4.6   | 1.7   | 8.3               |
| Foreign direct investment    | 24.5  | 33.5  | 43.6  | 67.2  | 83.7  | 95.5  | 109.5             |
| Portfolio equity flows       | 3.2   | 7.2   | 11.0  | 45.0  | 32.7  | 32.1  | 45.7              |

Note: Developing countries are defined as low- and middle-income countries with 1995 per capita incomes of less than \$765 (low) and \$9,385 (middle).

a. Preliminary.

Source: World Bank Debtor Reporting System.

Net private capital flows to developing countries by country group, 1990-96

(billions of U.S. dollars)

| Country group or country                 | 1990 | 1991 | 1992 | 1993  | 1994  | 1995  | 1996 <sup>a</sup> |
|--|------|------|------|-------|-------|-------|-------------------|
| All developing countries                 | 44.4 | 56.9 | 90.6 | 157.1 | 161.3 | 184.2 | 243.8             |
| Sub-Saharan Africa                       | 0.3  | 0.8  | -0.3 | -0.5  | 5.2   | 9.1   | 11.8              |
| East Asia and the Pacific                | 19.3 | 20.8 | 36.9 | 62.4  | 71.0  | 84.1  | 108.7             |
| South Asia                               | 2.2  | 1.9  | 2.9  | 6.0   | 8.5   | 5.2   | 10.7              |
| Europe and Central Asia                  | 9.5  | 7.9  | 21.8 | 25.6  | 17.2  | 30.1  | 31.2              |
| Latin America and the Caribbean          | 12.5 | 22.9 | 28.7 | 59.8  | 53.6  | 54.3  | 74.3              |
| Middle East and North Africa             | 0.6  | 2.2  | 0.5  | 3.9   | 5.8   | 1.4   | 6.9               |
| Income group                             |      |      |      |       |       |       |                   |
| Low-income countries                     | 11.4 | 12.1 | 25.4 | 50.0  | 57.1  | 53.4  | 67.1              |
| Middle-income countries                  | 32.0 | 44.0 | 64.8 | 107.1 | 104.2 | 130.7 | 176.7             |
| Top country destinations <sup>b</sup>    |      |      |      |       |       |       |                   |
| China                                    | 8.1  | 7.5  | 21.3 | 39.6  | 44.4  | 44.3  | 52.0              |
| Mexico                                   | 8.2  | 12.0 | 9.2  | 21.2  | 20.7  | 13.1  | 28.1              |
| Brazil                                   | 0.5  | 3.6  | 9.8  | 16.1  | 12.2  | 19.1  | 14.7              |
| Malaysia                                 | 1.8  | 4.2  | 6.0  | 11.3  | 8.9   | 11.9  | 16.0              |
| Indonesia                                | 3.2  | 3.4  | 4.6  | 1.1   | 7.7   | 11.6  | 17.9              |
| Thailand                                 | 4.5  | 5.0  | 4.3  | 6.8   | 4.8   | 9.1   | 13.3              |
| Argentina                                | -0.2 | 2.9  | 4.2  | 13.8  | 7.6   | 7.2   | 11.3              |
| India                                    | 1.9  | 1.6  | 1.7  | 4.6   | 6.4   | 3.6   | 8.0               |
| Russia                                   | 5.6  | 0.2  | 10.8 | 3.1   | 0.3   | 1.1   | 3.6               |
| Turkey                                   | 1.7  | 1.1  | 4.5  | 7.6   | 1.6   | 2.0   | 4.7               |
| Chile                                    | 2.1  | 1.2  | 1.6  | 2.2   | 4.3   | 4.2   | 4.6               |
| Hungary                                  | -0.3 | 1.0  | 1.2  | 4.7   | 2.8   | 7.8   | 2.5               |
| Percentage share of top twelve countries | 83.6 | 76.8 | 87.4 | 84.1  | 75.4  | 73.3  | 72.5              |

Note: Private flows include commercial bank lending guaranteed by export credit agencies.

a. Preliminary.

b. Country ranking is based on cumulative 1990-95 private capital flows received. Private flows include commercial bank loans guaranteed by export credit agencies.

Source: World Bank Debtor Reporting System and staff estimates.