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THE DETERMINANTS OF FOREIGN DIRECT INVESTMENT IN AFRICA

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3.1 INTRODUCTION

Africa faces significant challenges in low growth, persistent poverty and high inequality. The Economist of 24^{th} February 2001 refers to an "elusive dawn" in Africa, as African leaders' Millennium African Renaissance Programme confronts war, disease, corruption and half of sub-Saharan Africa's 600 million people living in absolute poverty. It may be argued that foreign direct investment (FDI) presents a possible solution to the growth and development challenges in Africa. FDI supplies capital and provides for spillovers of foreign technology and know-how to host economies. This may aid growth and development. Currently many African governments are reshaping their policy frameworks in an effort to attract FDI. Yet there has been little empirical work done on the determinants of FDI in Africa.

This chapter provides a theoretical and empirical analysis of the determinants of FDI in sub-Saharan Africa. Theories of the internationalisation of production are used to outline the reasons why multinational enterprises (MNEs) undertake FDI. These reasons help to identify the conditions and policies that might draw FDI to Africa. The empirical analysis tests for the significance of a number of hypothesised determinants of FDI, in sub-Saharan Africa. The pooled cross-country and time series estimation covers the period 1980 to 1999 for 17 countries. The results show the importance of economic growth, domestic investment and macroeconomic stability, for attracting FDI.

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Section 2 introduces the challenges facing African countries and presents FDI as a possible solution. The case is made for the significance of identifying the determinants of FDI in Africa. In section 3 the theory and evidence of the determinants of FDI are examined. Dunning's (1993) OLI-theory serves as the basis for current thinking on the determinants of FDI. The overview of recent empirical findings shows the importance of economic variables such as market size and wage costs as determinants of FDI. The empirical analysis for sub-Saharan African countries is presented in section 4. Section 5 provides some conclusions and recommendations.

3.2 THE POTENTIAL ROLE OF FDI IN AFRICA

The so-called African development "tragedy" defines the continent's lack of growth, and limited development. Over the last four decades Africa has been the only region where per capita income fell, while the average global per capita income doubled (ADR, 2000). In Africa an estimated 350 million people live on $1 per day or less. Ranked by Human Development Index, eighteen of the world's twenty lowest ranked countries are in Africa (World Bank, 1999). Although the African economic scene of the late 1990s offers some hope of recovery in a number of countries, the challenge remains that of accelerating broad-based economic growth for development. FDI has been put forward as a possible solution to this challenge.

FDI is an amalgamation of capital, technology, marketing and management[2] (Cheng & Kwan, 2000). Over the past twenty years international production and FDI has grown rapidly. At the end of 1999 the global stock of FDI stood at $5 trillion. The ratio of world FDI inflows to global capital formation was 14 per cent in 1999 - compared with 2 per cent twenty years ago. The role of foreign capital in developing countries has grown in accordance with the global trends. In 1999 developing countries received $208 billion in FDI. That constituted an increase of 16 per cent over 1998 and an all-time high (WIR, 2000). These FDI flows are argued to benefit growth and development.

In host countries, labour is combined with domestic and foreign owned physical capital in the production process. FDI affects growth directly by increasing the stock of physical capital - new inputs supplement those in the production process. Investment drives capital accumulation, which drives growth. FDI affects growth indirectly through effects concomitant with greater openness: technology spillovers and knowledge transfers (De Mello, 1999). Technology spillovers from TNCs promote technological upgrading in the host

[2] For measurement purposes FDI refers to net inflows of investment to acquire a lasting management interest (ten per cent or more of voting stock) in an enterprise operating in an economy other than that of the investor (Hawkins & Lockwood, 2001).