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Why and how least developed countries can receive more FDI to meet their development goals

by
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The 48 least-developed countries[1] (LDCs), most of them in sub-Saharan Africa and a few in Asia, need foreign direct investment (FDI) to help meet their development targets. The FDI they now receive, although inadequate, is enough to demonstrate that investors see potential in them. It is therefore realistic for LDCs to seek more FDI, but they need to enhance their investment environments to attract it in the much greater quantities required. Donors can help by targeting official development assistance (ODA) on investment in human capital and supporting governance improvements. Meanwhile, LDCs should establish effective investment promotion agencies (IPAs).

Have multinational enterprises (MNEs) shown any interest in investing in LDCs? Perhaps surprisingly, LDCs have recently been punching above their weight in bringing in FDI, despite their reputation for inadequate infrastructure and governance. In 2006-2009, average FDI inflows to LDCs were 1.7% of the global total – over twice these countries' share of world GDP and capital formation.[2] The LDCs' share in the world's FDI stocks was 0.6%. FDI inflows to LDCs have increased sharply, averaging US$ 27 billion per year in 2006-2009 compared to US$ 10 billion in 2000-2005, US$ 2.5 billion in the 1990s, and US$ 506 million in the 1980s. FDI inflows to LDCs in 2001-2010 exceeded portfolio and other private capital inflows and also

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[1] LDCs are defined by three criteria: low GNI per capita, weak human assets and economic vulnerability.

[2] Unless otherwise cited, the statistics in this *Perspective* are taken, or calculated, from the online UNCTAD statistical database, UNCTADstat, at http://unctadstat.unctad.org/.

exceeded bilateral aid inflows.[3] FDI flows for the world as a whole in 2006-2009 averaged 2.9% of GDP, while they were 6.3% of GDP in LDCs (compared to 2.6% in developed economies, 4.6% in transition economies and 3.6% in developing economies). FDI flows were 13% of gross fixed capital formation globally in 2006-2009 but 48.5% in LDCs; world FDI stocks were 131.7% of gross fixed capital formation, LDC FDI stocks 117.7%, not far behind, similarly indicating an upward trend.

A major example of this trend is Africa, where most LDCs are situated. Africa is becoming increasingly attractive to international investors, particularly from emerging markets. FDI from emerging markets into Africa grew at a compound annual rate of 13% a year from 2003 to 2010. While investors from developed countries tend to be more cautious in their African investments, they still account for the largest share of FDI in the continent and are investing in a diverse range of sectors – not just mineral resources – including telecommunications, food, beverages and tobacco, transport, storage and hotels. But the most rapid FDI growth in Africa (a 21% compound growth rate from 2003 to 2010) is being achieved by Africans investing in other African countries. [4]

While the picture is improving, current FDI inflows to LDCs are still nowhere near enough to meet Africa's needs. Total fixed investment in LDCs is now approximately 20% of GDP, insufficient to support the sustained growth needed to meet the Millennium Development Goal (MDG) of halving the proportion of the world's population with incomes below a dollar a day and other MDGs such as universal primary education and basic health targets.[5]

FDI is also distributed unevenly among LDCs: in recent years, over 80% has gone to resource-rich countries in Africa like Angola and Sudan, while inflows have stagnated or declined in some other LDCs, including Burkina Faso, Djibouti and Mauretania. Those LDCs that received FDI inflows in their extractive sectors tend not to have benefited from similar levels of FDI in services and manufacturing, where job creation, linkages and skills transfers are greater.[6]

What can LDCs do to promote stronger FDI inflows to all sectors of their economies, especially those that have a strong positive impact on development, such as manufacturing and services? In the short term, LDCs should establish effective investment promotion agencies at national and subnational levels to ensure their visibility as investment destinations. Long-term actions, which should be initiated as soon as possible because of the long gestation period, include building physical infrastructure and investing heavily in human capital. Necessary governance improvements, which also take time, include building a transparent and rules-based regulatory framework to provide predictability in areas such as property rights, competition and anti-corruption.

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[3] UNCTAD, *Foreign Direct Investment in LDCs: Lessons Learned from the Decade 2001-2010 and the Way Forward* (New York and Geneva: United Nations, 2011).
[4] Ernst & Young, "It's time for Africa: Ernst & Young's 2011 Africa Attractiveness Survey," (Johannesburg and London: Ernst & Young, 2011).
[5] UNCTAD, op.cit.
[6] Ibid.

ODA still exceeds FDI inflows to LDCs, but is not easy to expand when there are other demands on the funds of donor countries and international bodies. On the other hand, MNEs have investment funds looking for a good home, so FDI is well placed to fill the gap between domestic savings and LDCs' investment requirements and also find opportunities for investment in activities that might not attract less-experienced domestic LDC investors. It can also bring benefits like increased employment and improvements in technology, including via spillovers to local industry. LDC governments' limited development funds can be supplemented by well-targeted ODA and by FDI, for example through public-private partnerships in infrastructure. If effectively and efficiently utilized to build a business environment that will attract and promote sustainable FDI, such funding will eventually facilitate self-sustaining growth.

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The Vale Columbia Center on Sustainable International Investment (VCC), led by Dr. Karl P. Sauvant, is a joint center of Columbia Law School and The Earth Institute at Columbia University. It seeks to be a leader on issues related to foreign direct investment (FDI) in the global economy. VCC focuses on the analysis and teaching of the implications of FDI for public policy and international investment law.

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