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Myopic reliance on natural resources: How African countries can diversify inward FDI

by

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Recent inward foreign direct investment (IFDI) trends across African countries are encouraging: IFDI into Africa registered almost US$ 20 billion in 2001; it reached almost US$ 43 billion in 2011.[1] But, African countries need to do more.

Most of Africa's IFDI flows occur in the natural resources sector (i.e., oil and gas, mining). This is understandable given that the continent is well endowed with natural resources. But when thus concentrated, IFDI's positive effects in terms of job creation, technology and skills transfer, backward linkages, and economic growth are limited.[2] Luckily, there are alternatives.

Africa has potential comparative advantages in labor-intensive manufacturing, agro-processing and such knowledge-based services as information and communication technology and finance. However, to improve their attractiveness as destinations for more diverse IFDI, African countries must address two big deficits: the infrastructure deficit and the skills deficit.

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[1] Both 2001 and 2011 FDI figures are from UNCTAD FDI database available at: www.unctad.org/fdistatistics.

[2] UNCTAD, *World Investment Report 2001: Promoting Linkages* (New York: UNCTAD, 2001), p. 138; Laura Alfaro, "Foreign direct investment and growth: Does the sector matter?" Harvard University, Harvard Business School, Working Paper (2003).

In comparison to China and other East Asian economies, Africa lacks adequate infrastructure. Africa's low labor costs -- as a result of its young and abundant labor force -- could attract IFDI in labor-intensive manufacturing. However, the continent's comparative advantage of low labor costs is offset by the high cost of its bad infrastructure. Four types of infrastructure will matter the most for diversifying IFDI: power, transportation, water supply and sanitation, and telecommunications.[3] Africa has been witnessing a significant improvement in telecommunications infrastructure thanks to mobile phones. But power, transportation and water supply continue to present major bottlenecks that easily put off potential investors in the manufacturing sector, which depends heavily on such infrastructure.

This infrastructure deficit is a huge challenge, and its impact on IFDI is just one of its many negative effects. According to Africa Infrastructure Country Diagnostic, the continent needs US$ 93 billion in annual investment to make its infrastructure adequate; but, the continent is only receiving US$ 45 billion annually (US$30 billion domestically and US$ 15 billion from external sources), leaving a gap of US$ 48 billion.[4]

Finding funds to address the infrastructure deficit is daunting. A primary imperative is for African countries to find and tap into new sources of financing. Increasing investment from China represents one opportunity. In that sense, recent developments in China-Africa cooperation are encouraging. Indeed, during the fifth ministerial conference of the Forum on China-Africa Cooperation, the Chinese government pledged to double its funding to Africa to US$ 20 billion -- mainly to support the development of infrastructure, agriculture, manufacturing, and the development of small and medium-sized enterprises.[5]

African governments should also continue to pursue public-private partnerships (PPPs) and regional infrastructure investments to address the continent's infrastructure deficit.

PPPs are increasingly seen in Africa as an essential institutional mechanism to provide infrastructure. According to the World Bank's private participation in infrastructure project database, during the period from 1996 to 2006, the total number and value of such projects in sub-Saharan Africa were 289 and US$ 40.7 billion, respectively. These figures are higher than those of many other developing regions, and PPPs have contributed to Africa's infrastructure. However, in many African countries where public institutions are weak, institutional frameworks and state capacity should be strengthened to improve PPPs' effectiveness.

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[3] On Africa's infrastructure shortage, see Tonia Kandiero, "Infrastructure Investment in Africa," AfDB Development Research Brief No. 10 (August 2009).
[4] Vivien Foster and Cecilia Briceño-Garmendia, eds., "Africa's infrastructure: A time for transformation," Africa Infrastructure Country Diagnostic (2009), overview pp. 6-8.
[5] Forum on China-Africa Cooperation, "The fifth ministerial conference of the forum on China-Africa cooperation Beijing action plan (2013-2015)" (June 23, 2012), available at: http://www.focac.org/eng/zxxx/t954620.htm.

The West African Gas Pipeline Project is one recent regional infrastructure project. It consists of a 681 kilometer pipeline to transport natural gas from Nigeria to Benin, Ghana and Togo.[6] This is a good initiative and African leaders should try to replicate such projects across the continent, because regional infrastructure would enable economies of scale and reduce infrastructure costs for individual countries.

The skills deficit is the other key obstacle to diversifying IFDI. While the level of education has improved, Africa still lags behind other competing areas -- like China and India -- in terms of skills that match investors' needs. One way to meet this challenge is to develop educational policies that emphasize the training and orientation of students toward sectors in which African countries have effective or potential comparative advantages. The three sectors mentioned earlier (agro-processing, light manufacturing, knowledge-based services) will be especially crucial for general and vocational education orientation. Though skills issues have recently started being considered in policy discussions, more efforts are needed to push the skills agenda further.

Actions in several more areas are necessary. But actions involving infrastructure and skills will make a significant difference in creating space and opportunities for IFDI to enter sectors -- other than the natural resources sector -- in African countries.

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[6] More information about the project can be found at: http://wagpa.org/documentation.html.

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