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Capital Flows to Africa: An Analysis of the Structure of Official and Private Capital Flows

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Abstract

Although globalization was built on increased world trade, the movement of capital has accelerated faster in the past two decades. It is this free flow of capital that is offering African countries renewed hope of tapping global markets for the much needed resources to aid their economic growth while becoming fully integrated into the global economy. While past studies tackling external resource flows to Africa have focused on either official or private capital flows, this paper analyses both types of capital flows with the intention of providing a clearer picture on composition and magnitude of external resources to Africa. Three types of capital flows – Official Development Assistance (ODA), Foreign Direct Investment (FDI) and Workers Remittances – emerge as key to tackling Africa's development problems. Together, these flows account for the bulk of resources to Africa. In addition, they have built-in advantages for economic development hence are more suited to addressing Africa's growth challenges. To this end, African countries must enact policies that directly relate to aiding effectiveness of these flows.

1. Introduction

Lack of investment capital has been blamed for the lack of economic progress in African economies. It is therefore not surprising that attracting capital flows has been at the core of strategies advocated by policy makers worldwide[1]. However, the problem with strategies put forward has been the lack of consistency in the types of capital flows ideal for Africa. Initial studies placed a lot of emphasis on official flows, while recent studies have focused on private capital flows particularly foreign direct investment. Given the limitations inherent in each strategy, the central thrust of this paper is that a holistic approach to capital flows seems appropriate. To this end, focus of African countries must be to enact policies that create and enhance synergies between the various types of flows.

Africa's need for external resources is demonstrated by its wide savings-investment gaps spanning a magnitude of well over 20 percent. Lately, the need for external resources has been highlighted by Africa's sluggish progress towards achievement of the Millennium Development Goals, hence the need to harness both official and private capital flows. Against this backdrop, African economies have embarked on extensive reforms and liberalization of their economies to be the choice destinations of foreign capital. While Africa's performance has not been spectacular, it is important to understand what has been happening by revisiting trends of capital flows with the main purpose of identifying relevant flows for Africa's economic progress.

In this study, we analyze trends in disaggregated foreign capital inflows. The trends in Africa are analyzed from the perspective of flows to developing countries. The

[1] UNCTAD (2005): "Economic Development in Africa- Rethinking the Role of Foreign Direct Investment". 13 September, United Nations, Geneva.

main aim of the paper is to shed light on the composition, magnitude, source and sectoral distribution of capital flows to Africa.

The remainder of the paper is organized as follows: Section 2 presents trends of capital flows to developing countries and narrows down to trends in Africa. Sections 3, 4 and 5 examine in detail official development assistance, foreign direct investment and workers remittances, respectively. Section 6 concludes and discusses policy recommendations.

2. Capital Flows to Developing Countries

Developing countries are recipients of both official and private capital flows. Official flows consist of official development assistance and official aid that come in the form of grants or loans. Most of the official flows originate from individual country governments as bilateral flows or from the World Bank or IMF as multilateral flows. Private capital flows, on the other hand include bank and trade related lending, foreign direct investment, portfolio investments, and lately workers' remittances.

According to UNCTAD's 2000 report, collective capital inflows to developing countries have gone through three distinct phases since the mid-1970s:

- From 1975 to the early 1980s, total inflows increased rapidly mainly as a result of a surge in syndicated bank lending. During this period, official financing was sustained although its share in the total fell.
- The 1980s saw the outbreak of the debt crisis that led to a decline in total inflows due to reduced bank lending.

❖ The 1990s and beyond witnessed a sharp increase in total capital inflows as a result of a surge in private capital flows, notably portfolio and foreign direct investment, while official flows declined. Commercial bank loans accounted, on average, for roughly one-tenth of private capital flows to developing countries over the period 1990-1997, portfolio investment for about a third, and FDI for about a half of such flows (UNCTAD, 1998). Table 1 below illustrates the trend from 1991 to 2004.

Table 1: Private Capital Flows and Officials Flows to Developing Countries
(Billion of Dollars)

Year	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004e**
Total Capital Flows	123.0	155.8	220.4	223.7	261.2	311.2	342.6	334.9	264.5	295.8	205.2	200.9	282.1	323.8
Net Private Flows	62.1	99.3	166.8	175.7	206.1	279.3	299.8	280.3	219.2	256.4	150.3	163.5	250.4	301.3
Net Official Flows	60.9	56.5	53.6	48.0	55.1	31.9	42.8	54.6	45.3	38.6	54.9	37.4	31.7	22.5
Share of ODA/Total (%)	49.5	36.3	24.3	21.5	21.1	10.3	12.5	16.3	17.1	13.0	26.8	18.6	11.2	6.95

Source: Various *World Bank Global Development Finance Reports*, (e = estimate)

The latest UNCTAD reports show that foreign direct investment has gained a lot of steam in the past few years, but the 2006 Global Development Finance Report declares 2005 a landmark year in global development finance in both the official and private spheres. However, analyzing the aggregate figures for developing countries shields a lot of variations within regions (see Figures A.1- A.5 in the Appendix). Africa has long been a non-participant of bank and trade related lending while it receives very little portfolio investments. Contrary to what is suggested by the aggregate trends, ODA flows to Africa have remained strong, declining moderately but still maintaining an upward trend[2]. Figure A.6 clearly shows ODA, FDI and workers' remittances to be the most significant

[2] Figures include debt relief.

flows for Africa. These three types of flows are in turn analyzed in detail in the next sections.

3. Official Development Assistance to Africa

ODA defined as those flows originating from official agencies, including state and local governments, has been used to put up infrastructure critical for the development of other sectors of the economy. By characterization, ODA includes capital projects, food aid, emergency relief, peace keeping efforts and technical cooperation (Ali, Malwanda and Suliman, 1999). With ODA flows' main objective as promotion of economic development and welfare of developing countries, ODA has long repayment horizons suitable for infrastructure projects with long gestation periods. In addition, ODA's concessionality makes it affordable to poor country governments typical of African economies.

ODA flows to Africa declined as part of a broader trend of the decline in total official flows to developing countries in the late 1990s, but remained a significant component of external financial flows to the region. Throughout the past three decades ODA flows show a general upward climb in nominal terms growing significantly between the mid-1970s and early 1990s and resuming growth again in 2001 due to debt relief (Figure A.6).

African countries in the past three decades continued to rely on ODA more heavily than other regions of the developing world (Figure A.2). For instance, while ODA flows to Africa were as much as $33 per capita in 1991, the average ODA of other low-income countries was $14 per capita. Similarly, while ODA flows contributed to 5.3

percent of African GNP in 1996, the corresponding proportion for other low-income countries was lower at 3.5 percent (Ali et al, 1999). White (2003), by further breaking down the regions and looking at specific years, creates a slightly different picture showing slackening of assistance to Africa (Table 2).

Table 2: Regional allocation of net ODA, 1980–2000 (share and per capita)

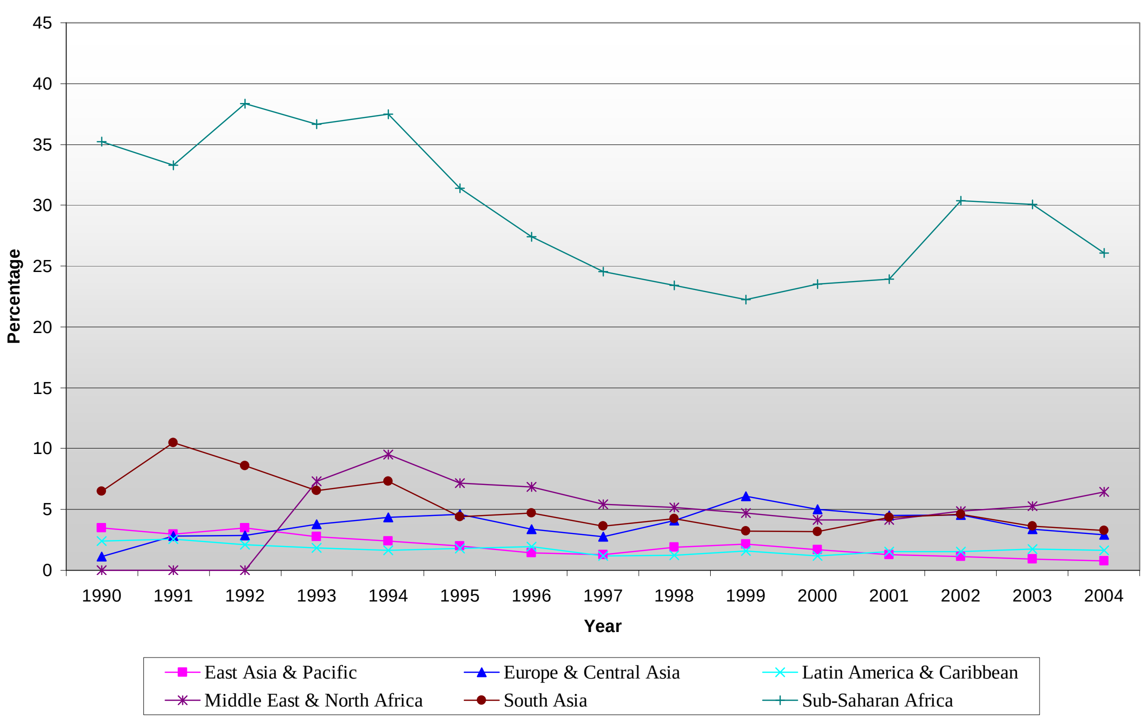
	Share (% of total Aid)			Per capita (US$)		
	1980	1990	2000	1980	1990	2000
North Africa	8.1	12.4	4.3	42	68	18
Sub-Saharan Africa	22.5	30.9	25.3	27	38	22
South America	2.4	3.6	4.7	5	8	8
Middle East	15.9	8.2	4.6	76	40	16
South and Central Asia	16.7	10.6	11.5	8	5	4
Far East Asia	7.8	12.1	15.4	3	5	5
Other	26.7	22.2	34.3	66	60	72
of which Europe	3.6	2.5	7.4	19	16	43
Total	100	100	100	14	15	12

Source: *White (2003), pg 8*

The slight slackening of assistance to Africa can be partly explained by a shift of European donors to fellow European countries. For example, the Federal Republic of Yugoslavia and Bosnia–Herzegovina are now among the top recipients of aid from Norway, Sweden, and Switzerland all of whom have seen a reduction in their share of aid going to Africa of more than 10% (White, 2003). In addition, more aid is going towards trouble spots around the globe, such as Iraq and Afghanistan, and lately as emergency relief to tsunami-affected areas.

Some of the recent boost in ODA flows reflects debt relief granted under the HIPC Initiative and other special purpose grants both directly attributable to the efforts of the G-8 countries to put Africa on a sustainable development path. Debt relief grants in 2005 totaled $23 billion, up more than five-fold of its 2004 figure. The graph below shows that aid to Sub-Saharan Africa (SSA) as percentage of total aid has, for the most part, been more than triple that of other regions emphasizing the importance of these official flows to the region.

Figure 1: Aid (% of Gross Capital Formation)



Source: World Development Indicators

The top recipient countries for ODA within Africa have varied although, since the late 1990s, the list has included Democratic Republic of Congo, Tanzania, Mozambique, Uganda, Madagascar, Ghana, Ethiopia and Zambia (Ali et al 1999, Figure A.7). These countries are part of those classified as Heavily Indebted Poor Countries (HIPCs). Most of the aid goes to the social sector of the economy for purposes of improving education, health and infrastructure development[3].

While African governments have little control over the official assistance they receive, they must use the aid effectively to build infrastructure that support growth in

[3] Statistics on sector allocation of aid and aid donors are already presented in summary form by OECD. http://www.oecd.org/dataoecd/40/27/7504863.PDF

other sectors of the economy. Since sound infrastructure is one of the determinants of FDI, wise use of official assistance can spur growth of FDI and other types of private capital flows. This seems to be already happening in Ghana, a country that was once a major recipient of ODA and now is among the top ten recipients of FDI in Africa[4]. FDI flows are the second largest flows to African economies and have the advantage that they can be influenced by country governments.

4. Trends in Foreign Direct Investment

Foreign direct investment is defined as an investment involving a long-term relationship and reflecting a lasting interest and control of a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor. FDI typically occurs when the parent company:

- Obtains sufficient common stock in a foreign company to assume voting control;
- Acquires or constructs new plants and equipment overseas;
- Shifts funds abroad to finance an expansion of its foreign subsidiary; or
- Reinvests earnings of the parent company's foreign subsidiary in plant expansion (Carbaugh, 2002).

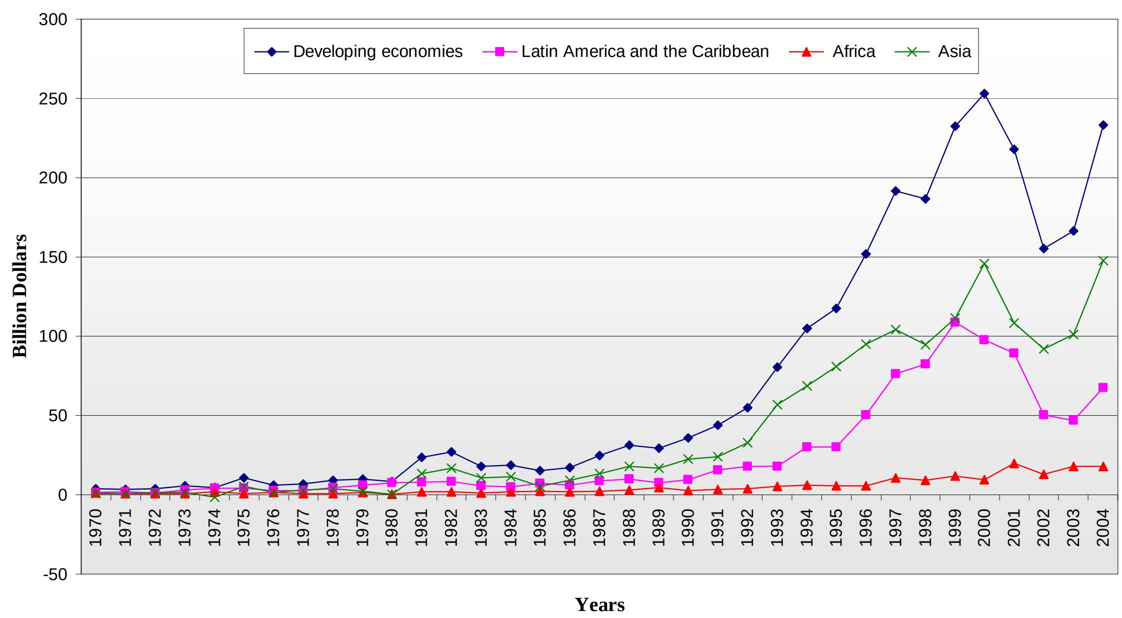
Compared to other sources of private capital flows, FDI has become the investment vehicle of choice. One critical distinguishing factor of FDI is that it is motivated largely by the investor's long term prospects for making profits in the activities that they control. Consequently, FDI has proved resilient during financial crises, creating stability that developing nations require for continued economic growth. Second, FDI has some

[4] http://www.gipc.org.gh/documents/WebRPT3Q06.pdf

inherent advantages for development: non-debt creating, risk sharing, market discipline, export orientation, and the transfer of technology and managerial expertise. It with such attributes in mind that the economics literature has emphasized the role of FDI for Africa's development. Without FDI, Africa would foreclose its option to growth. With growth foreclosed, there would be no way out of Africa’s poverty and its attendant problems (Ikiara, 2003; Tandon, 2000[5]).

A glance at FDI statistics shows a tremendous upward climb in the last decade of global flows. These impressive figures, however, disguise considerable variation across and within regions. For example, while flows to developing countries increased between 1970 and 1994 from $5 billion to $173 billion, three-quarters of this money went to just ten countries, mostly in East and South-East Asia and Latin America.

Figure 2: FDI Inflows to Developing Countries and Select Regions, 1970-2004

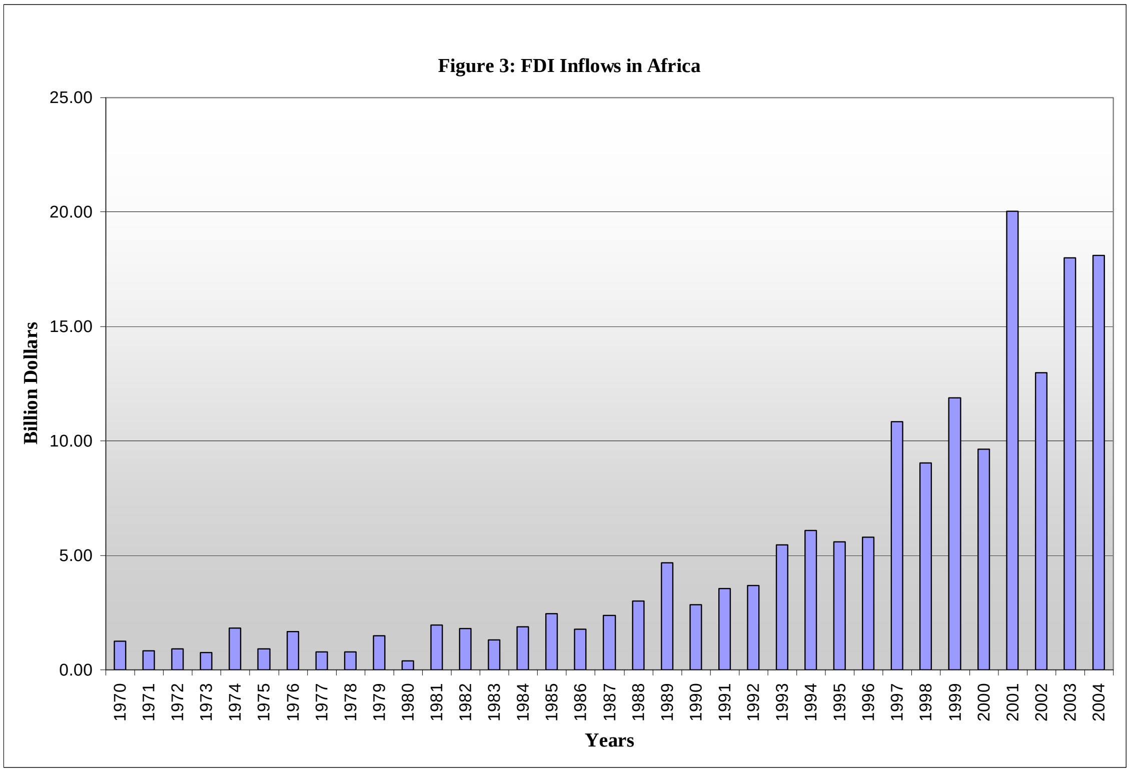


Source: *UNCTAD, FDI/TNC Database*

[5] The statement was used as rhetoric.

In general, FDI flows into Africa were low and rather static prior to 1980, except during and following the oil crises in 1974 when heavy investments were made in the oil producing countries (UNCTAD, 1999). However, it should be noted that prior to 1980, FDI inflows in developing countries as a whole were relatively insignificant in comparison to those of the world total. FDI inflows to the developing countries increased continuously from 1983 to reach about $30 billion in 1989 (UNCTAD, 1991). From 1985, those flows grew at an annual rate of 22 percent compared to 3 percent from 1980 to 1984 and 13 percent from 1975 to 1979.

The trend in Africa, though positive, has been unimpressive as the continent lagged behind other developing regions. FDI inflows steadily increased from an annual average of approximately $0.9 billion in 1970-80 to $2.4 billion in 1981-1990 and $7.1 billion in 1991-2000 (see Figure 3 below). They reached their peak in 2001, reaching approximately $20 billion before falling drastically in 2002 and peaking again in 2003.



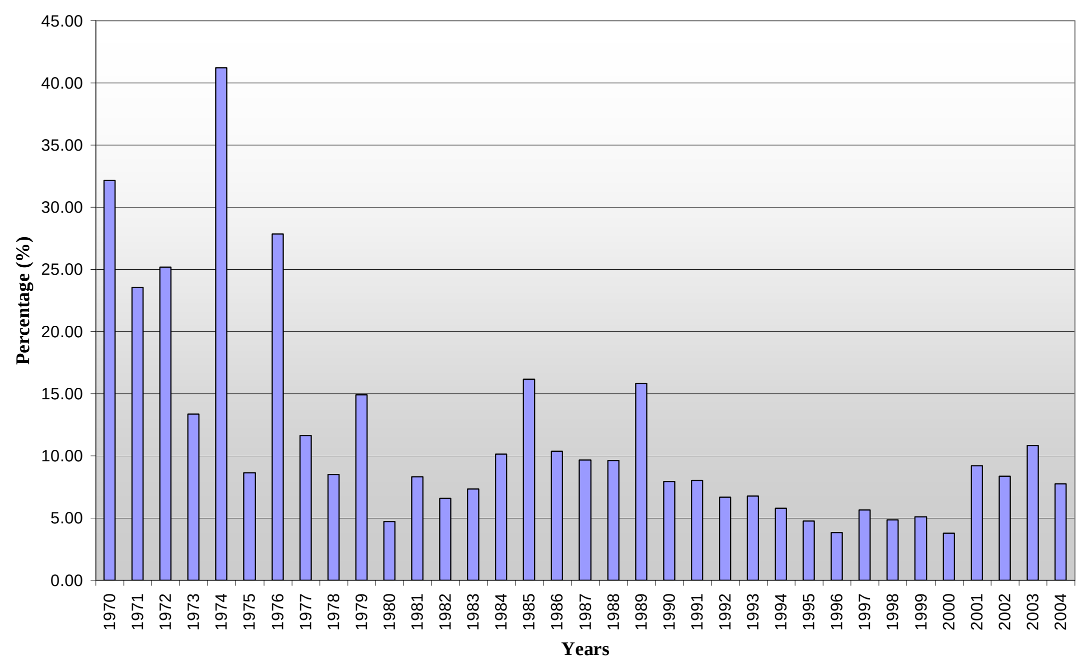
Source: *UNCTAD, FDI/TNC online Database*

However, though FDI inflows into Africa show a general upward movement in absolute terms, Africa's share of total FDI relative to all developing countries has been thinning. Inflows to developing countries as a group quadrupled from an average of $20.4 billion in 1981-1985 to an average of $81.6 billion in the 1991-1995 period, whereas inflows into Africa only doubled during that time. Inflows to developing countries and Africa both doubled for the 1996-2001 period. As a result, Africa's percent share in total inflows to developing countries dropped significantly from a high of 23 percent in 1970-75 to almost 11 per cent in 1976-80, 6 percent in 1991-1995 and to 4.7 percent in 1996-2000 (see Figures 2 and 4). Furthermore, the UNCTAD FDI data shows that foreign direct investment to Africa declined from $12.8 billion in 1999 to $8.7 billion in 2000, bringing down the share in world FDI inflows to below 1%. Analysis shows that the decline was mostly attributable to the decrease of inflows into Angola, mainly due to cyclical investment behavior in its petroleum extraction industry, and South Africa, as a result of reduced privatization and mergers and acquisitions activity (UNCTAD, 2000). During the same time, strong increases in flows were reported for Lesotho, Mauritius and Tanzania, while flows were largely unchanged for the rest of FDI recipients (Landrey et al, 2002). Within SSA, the Southern Africa Development Community[6] (SADC) remained the most important sub-region in terms of FDI inflows.

Africa's share in total average annual inflows to developing countries increased from 9 percent in the 1980-1984 period to 12 percent in the 1985-1989 period, with oil exporting countries in Africa accounting for the bulk of the increase. In absolute terms, inflows to Africa reached $4.3 billion in 1989, two times the level reached in the early 1980s. FDI in SSA countries also increased significantly, although Nigeria received most of those flows. For the non-oil exporting SSA countries, FDI inflows remained below $0.5 billion during this period. In the 1990s, the average share was slightly above 5 percent and increased in the 2000s to average more than 10 percent, an increase that could be attributed to increased flows into the region from other developing countries.

[6] The countries of the SADC are: Angola, Botswana, Democratic Republic of Congo, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, United Republic of Tanzania, Zambia and Zimbabwe.

Figure 4: The share of Africa FDI inflows in total flows into developing countries, 1970-2004



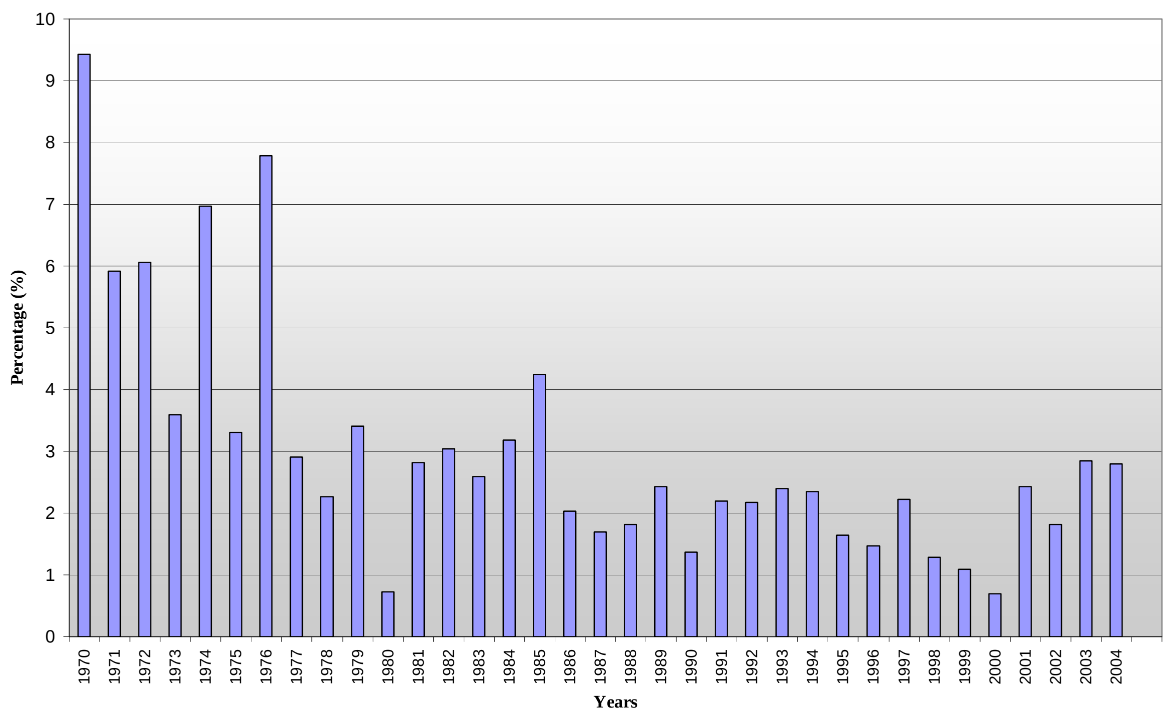
Source: *UNCTAD, FDI/ TNC Database*

At the global level, 1993 marked the end of the FDI recession that had prevailed in 1991 and 1992, with global outflows increasing by 17 percent to reach $222 billion. It was maintained at almost the same level in 1994. At about $3 billion in 1993 and $3.1 billion in 1994, FDI flows into Africa remained stagnant despite the liberalization of investment regimes by a number of countries (UNCTAD, 1995)[7]. As a result, Africa's share of all flows into developing countries declined to 5 percent compared with the 11 percent average during 1986-1990. In 1997, FDI flows amounted to more than $10 billion. At this level, the share of Africa in world total FDI remained a mere 2.3 percent amidst proclamation that 1997 was a year of significant rise in inflows. After this period,

[7] These figures are lower than those obtained recently online due to exclusion of flows to economies in North Africa and revisions in figures in the later publications.

the share slightly increased though it stayed below 3 percent according to the UNCTAD data as shown in Figure 5 below.

Figure 5: Africa FDI Inflows as a Percentage of World Total



Source: *UNCTAD, FDI/TNC online Database*

In 1998, FDI flows into developing countries declined by 4 percent due to mainly reduced FDI into Indonesia, Taiwan, and Hong Kong. Inflows to Africa (excluding South Africa) increased moderately compared to 1997. However, including South Africa, the continent registered a decline in FDI inflows. This result shows that South Africa is one of the big players in driving the FDI trends for the continent. A further decrease was registered in 2000 among SSA countries where total FDI in absolute terms went from $8 billion in 1999 to $6.5 billion in 2000. A sharp drop of inflows into Angola and South Africa mainly caused this decline. Zimbabwe also experienced a significant drop in inflows, from $444 million in 1998 to $59 million in 1999 and only $30 million in 2000 (UNCTAD, 2001). In 2001, FDI inflows rose again to almost double the amount received in 2000. This time, Angola was one of the best performing host economies for foreign direct investment, together with Hong Kong, China and Belgium (UNCTAD, 2002).

The year 2002 presented some very interesting results for the continent. Africa's inflows declined to $11 billion in 2002 after a surge to $19 billion in 2001. As a result, the region's share in global FDI fell from 2.3% in 2001 to 1.7% in 2002. Hidden within this trend is that if we exclude the large cross-border mergers and acquisitions (M&A) deals in Morocco and South Africa in 2001, FDI inflows in 2002 actually increased by 8 percent (UNCTAD, 2003). Thus it is noticeable that FDI fluctuations are really driven by a few major players, while for the rest of the continent there is stagnation. Finally, FDI inflows to Africa rose by 28 percent to $15 billion in 2003 but fell short of their 2001 peak of $20 billion. The recovery was led by investment in natural resources and a revival of cross border M&As. Not surprisingly, natural resource rich countries (Angola, Chad, Equatorial Guinea, Nigeria and South Africa) continued to be the principal destinations (UNCTAD, 2004).

When FDI is expressed as a proportion of each country's GDP, African economies appear to do much better. In fact, for the majority of the countries, there is little difference between Africa and other developing regions as regards inward FDI. Table 3, which presents figures for select countries in the developing world, best illustrates this point, with Equatorial Guinea, Lesotho and Angola standing out.

Table 3: Foreign Direct Investment as a share of GDP- 1990-2004

COUNTRY NAME	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Angola	-3.3	5.5	5.0	5.7	4.2	9.4	2.4	5.4	17.3	40.1	9.6	24.0	15.4	25.4	7.4
Botswana	2.5	-0.2	0.0	-6.9	-0.3	1.5	1.5	1.9	1.9	0.7	1.1	0.4	7.4	5.4	0.5
Chad	0.5	0.2	0.1	1.0	2.3	2.3	2.5	2.9	1.2	1.7	8.3	27.5	46.0	27.3	11.3
China	1.0	1.2	2.7	6.2	6.0	4.9	4.7	4.6	4.3	3.6	3.2	3.3	3.4	3.3	2.8
Equatorial Guinea	8.3	31.4	3.9	14.5	13.5	77.4	145	10.7	64.0	28.9	8.0	55.5	15.3	49.1	51.4
Ghana	0.3	0.3	0.4	2.1	4.3	1.7	1.7	1.2	2.2	3.2	3.3	1.7	1.0	1.8	1.6
India	0.1	0.0	0.1	0.2	0.3	0.6	0.6	0.9	0.6	0.5	0.8	1.1	1.1	0.8	0.8
Indonesia	1.0	1.2	1.3	1.3	1.2	2.2	2.7	2.2	-0.3	-1.3	-2.8	-1.8	0.1	-0.3	0.4
Lesotho	2.8	1.0	0.4	1.8	2.3	29.5	30.4	26.2	29.8	17.9	13.7	15.3	12.0	10.8	9.4
Mali	0.2	0.0	-0.8	0.1	1.0	4.5	1.7	2.5	0.3	0.1	3.4	4.6	7.3	3.0	3.7
Morocco	0.6	1.1	1.5	1.8	1.8	0.3	0.2	0.0	0.0	0.0	0.7	0.4	0.2	5.3	1.5
Mozambique	0.4	0.9	1.3	1.6	1.6	2.0	2.6	1.9	5.5	9.6	3.7	6.9	8.5	7.0	4.0
Nigeria	2.1	2.6	2.7	6.3	8.3	3.8	4.5	4.2	3.3	2.9	2.7	2.5	4.0	3.4	2.6
South Africa	-0.1	0.2	0.0	0.0	0.3	0.8	0.6	2.6	0.4	1.1	0.7	6.1	0.7	0.5	0.3
Swaziland	3.4	9.0	8.7	6.8	5.5	3.8	1.7	-1.0	11.4	7.3	6.6	2.2	7.5	-3.2	2.9
Tanzania	0.0	0.0	0.3	0.5	1.1	2.3	2.3	2.1	2.1	6.0	5.1	3.6	2.5	2.5	2.3
Uganda	-0.1	0.0	0.1	1.7	2.2	2.1	2.0	2.8	3.2	2.3	2.7	2.7	3.2	3.2	3.3
Zambia	6.2	1.0	0.0	9.6	1.2	2.8	3.6	5.3	6.1	5.2	3.8	2.0	2.2	4.0	6.2

Source: *World Bank Development Indicators*

China is one of the largest recipients of FDI in Asia but the amount it receives relative to its gross domestic product is less than that of countries like Lesotho in the Africa region, although Lesotho receives a very small amount in absolute value terms. Indonesian figures also portray a similar picture. Several other African countries receive more FDI relative to GDP than the average developing country. Moreover, for 22 of the 53 African countries, the ratio of FDI inflows to gross fixed capital formation in 1998-2000 was higher than that for developing countries as a whole[8].

Table 4: FDI Inflows as a Percentage of Gross Fixed Capital Formation

Year	**75-80**	**81-85**	**86-90**	**91-95**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**
Angola	0.0	4.7	7.6	52.98	6.9	21.1	48.6	86.8	28	66.7	49.7	43.9
Botswana	17.6	16.9	15.5	-4.52	6.6	8.6	7.8	2.7	4.3	2.6	33.1	6.9
Congo, Democratic Republic of	8.3	-1.4	-1.3	-0.12	2.8	-8.8	13.5	1.2	1.8	25.6	29	23.6
Lesotho	0.7	2.9	4.9	3.88	5.1	5.6	6.1	7.5	8.2	8.6	8.8	9.6
Malawi	5.1	4.6	3.6	0.72	7.1	6	6.2	26.1	11.4	10.1	4.3	12.4
Mozambique	0.2	0.1	0.7	7.2	12.6	9.3	33.1	47.9	7.5	33.1	20.8	29.9
Namibia	0.0	1.9	2.0	18.88	15.7	11.7	9.9	2.5	29	53	26	12.3
Seychelles	19.5	26.0	31.9	19.68	18	31.7	26.3	31.7	30.9	30.7	23	28.9
South Africa	-0.6	0.2	-0.4	1.68	3.5	15.5	2.5	7.5	4.7	40.9	4.8	3
Swaziland	20.6	5.4	41.5	31.52	8.3	-5.3	36.1	38.8	32.8	22.3	22.4	18.2
United Republic of Tanzania	0.5	0.6	0.1	4.4	13.9	14	12.8	40.8	17.8	29.8	14.9	15.6
Zambia	6.3	6.6	37.4	10.28	8.2	14.1	41.3	32.5	21.8	10.5	13.4	16.2
Zimbabwe	1.3	0.0	-1.0	2.7	5.2	8.9	33.8	6.7	2.5	0.5	3.5	2.5

Source: *UNCTAD FDI/TNC online database*

Flows of FDI as a percentage of gross fixed capital formation are comparable to the percentage with respect to official flows showing the importance of FDI to Africa. Table 4 gives a sample of the ratios for select countries. On the aggregate and in-line with the general trend in flows, FDI inflows as a percentage of gross fixed capital formation also grew from 12 percent in 2002 to 14 percent in 2003. The relatively high FDI/GFCF ratio reflects the relative smallness of many African economies, their inadequate

[8] See Appendix of the 2002 World Investment Report for more detail.

domestic savings and investment, and the relatively larger developmental impact of FDI in the continent (UNCTAD, 1999).

Table 5 below, from the 2005 World Investment Report, shows the volume of FDI inflows and ranking of African countries for 2003 and 2004.

Table 5: Africa – Country Distribution of FDI inflows, by Range, 2003, 2004

	2003	2004
Range	Economy *	Economy *
More than $2.0 billion	Angola, Morocco and Nigeria	Nigeria and Angola
$1.0-1.9 billion	Equatorial Guinea and Sudan	Equatorial Guinea, Sudan and Egypt
$0.5-0.9 billion	South Africa, Chad, Algeria, Tunisia and United Republic of Tanzania	Democratic Republic of the Congo, Algeria, Morocco, Congo, Tunisia, South Africa and Ethiopia
$0.1-0.4 billion	Ethiopia, Botswana, Mozambique, Congo, Egypt, Mauritania, Uganda, Gabon, Zambia, Côte d'Ivoire, Democratic Republic of the Congo, Namibia, Libyan Arab Jamahiriya, Ghana and Mali	Chad, United Republic of Tanzania, Côte d' Ivoire, Zambia, Gabon, Mauritania, Namibia, Uganda, Mali, Ghana, Mozambique, Libyan Arab Jamahiriya and Guinea
Less than $0.1 billion	Kenya, Guinea, Mauritius, Seychelles, Senegal, Benin, Lesotho, Togo, Zimbabwe, Burkina Faso, Gambia, Eritrea, Cape Verde, Madagascar, Niger, Djibouti, Malawi, Sao Tome and Principe, Rwanda, Guinea-Bissau, Central African Republic, Sierra Leone, Liberia, Comoros, Cameroon, Somalia, Burundi and Swaziland	Senegal, Swaziland, Mauritius, Benin, Gambia, Togo, Seychelles, Zimbabwe, Sao Tome and Principe, Lesotho, Botswana, Kenya, Madagascar, Burkina Faso, Djibouti, Eritrea, Cape Verde, Liberia, Niger, Malawi, Rwanda, Somalia, Guinea-Bissau, Sierra Leone, Burundi, Comoros, Cameroon and Central African Republic

Source*: UNCTAD, WIR 2005 (FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1).*
**Countries are listed in order of the magnitude of FDI inflows for each respective year*.

Source of Africa Bound FDI

The important sources of FDI for Africa in the 1980s and early 1990s were the European Union, Japan and the United States, the so-called "Triad". During the 1982 to1996 period, France, Germany and the United States accounted for 80 percent of FDI inflows to the continent (UNCTAD, 1997). Other countries gaining importance thereafter were Canada, Italy, and the Netherlands. Together with Norway, Portugal, and Spain, these countries helped to reduce the rate of decline of Africa's share of FDI. Between 1988-1992 and 1993-1997, these six countries increased their share in African FDI inflows from 8 percent to more than 22 percent (UNCTAD, 1999).

Over the past decade, a noticeable vitality in foreign investment has come from the developing countries themselves who are emerging as outward investors – the so called "South-South FDI." UNCTAD (2004), reports the South-South flows to be growing far faster than North-South flows. Africa is part of this broad trend, with investors from other developing countries, particularly South-East Asia, having emerged as new sources of FDI. A recent World Bank report indicates a massive increase in investment from China into SSA through the latter half of the 1990s: between 1990 and 1997, Chinese investment into Africa amounted to about $20 million, but from 1998 to 2002 that increased six-fold to $120 million (World Bank, 2004). The report indicates that there are 450 Chinese-owned investment projects in Africa, of which 46 percent are in manufacturing, 40 percent in services and only 9 percent in resource-related industries.

Taiwan has been a major source of FDI into Africa also. Taiwanese investment into South Africa increased substantially during the 1980s, but more recently, in response to the African Growth and Opportunities Act (AGOA), Taiwanese investment has entered several other Southern and East African countries. Currently, as many as 700 Taiwanese investment projects are present throughout sub-Saharan Africa (Gelb, 2005). The third Asian country that is rapidly growing as an important investment source in Africa is India. India is the largest investor in Ghana since 1994 with more than 225 projects (GIPC, 2006). An estimated 35 Indian companies are present in South Africa, but the figure is higher in terms of projects (Gelb, 2005).

Much less investment is coming into Africa from Latin America, although Brazilian firms are now starting to invest in other Lusophone countries in Africa, Angola and Mozambique in particular (Ibid). Other significant investors in the region include Lebanon and Portugal, albeit for select countries. For instance, Lebanese firms in Ghana are responsible for more than 175 projects since 1994 (GIPC, 2006).

Some African firms, particularly from South Africa and Nigeria, are becoming MNCs and also investing in other African countries. Since its democracy in 1994, South Africa has claim to over 600 projects in the continent[9]. It accounts for more than 50 percent of all investments to Botswana, Lesotho, Malawi, Swaziland and Democratic Republic of Congo. Nigerian firms on the other hand, are active in countries within the West African Region.

Sectoral Composition of FDI in Africa

Like the tendency to concentrate in a few countries, FDI in Africa has tended to concentrate in a few economic sectors, traditionally in natural resource industries such as mining and oil[10]. For example, U.S investment in SSA countries represents less than 1 percent of total U.S foreign direct investment and three-quarters of this goes to the petroleum industry. Moreover, the bulk of U.S investments are concentrated in just four countries: South Africa, Equatorial Guinea, Angola and Nigeria.

UNCTAD (1999) reports that FDI stock declined by half of the share in the primary sector between 1988 and 1997 globally, as well as in developed and developing countries. The services sector experienced a corresponding increase, again in both

[9] This is according to a press clipping count of investment projects done at The EDGE Institute in 2004 (in Gelb, 2005).
[10] An exception is South African investments, which cut across sectors.

developed and developing countries. Nevertheless, the share of the manufacturing sector remained stable, representing the single most important sector in developing countries. However, data for FDI flows to Africa from major home countries suggest that the primary sector has remained the most important over the past decade, with a 55 percent share in the accumulated FDI to Africa for the period 1996-2000. Oil and petroleum were largely responsible for this performance. Investment in banking and finance, transportation and trading boosted flows for the services industry, while food products as well as steel and metal products accounted for the largest share of FDI flows into the manufacturing sector. By observation, FDI in manufacturing has tended to concentrate on the local rather than the export market.

While oil accounted for the bulk of the increase in FDI inflows to Africa in 2003, FDI in services is increasing particularly in telecommunications, electricity and retail trade. In South Africa, FDI in telecommunications and information technology has overtaken that in mining and extraction. FDI in telecommunications is mainly in the mobile phone services. The number of Africans subscribing to mobile phone services grew from 1.2 million in 1996 to 51 million in 2003 (UNCTAD, 2004). According to the UNCTAD Press release of September 2004, World FDI flows shifted towards the services sector for the following reasons:

- ❖ A reflection of the ascendancy of services in economies more generally.
- ❖ The non-tradable nature of services. Most services need to be produced when and where they are consumed. As such, FDI has been the principal way to bring services to foreign markets.

- Liberalization of services FDI regimes in many countries, including privatization of state owned utilities.
- Service firms investing abroad as they seek new clients and exploit their ownership advantages.

In terms of source countries, FDI from Germany is going increasingly into manufacturing. More than 60 percent of British FDI stock in Africa is in the manufacturing and services sectors (UNCTAD, 1999). The share of US FDI stock in Africa that is in the primary sector dropped from 79 percent in 1986 to 53 percent in 1996. In terms of industries, US FDI going to manufacturing has been to food and related products, primary and fabricated metals, and other manufactures (UNCTAD, 1999). In South Africa, there has been a very rapid move by Indian conglomerates into both the services sector (IT, banking) as well as the manufacturing sector, including automotive, steel and pharmaceuticals. South African MNCs are in mining, financial services, breweries, food processing, retailing, civil engineering and construction, agriculture, tourism and hotels, and manufacturing. Other services include transport and telecommunications, and recently the oil and gas sectors, mostly in West Africa (UNCTAD, 1999; Gelb, 2005). Some African countries have also hosted South African investments in the commercial and retail sectors (South Africa Foundation, 2004).

A survey of MNCs in 2000 indicated that the sectors with the greatest potential to attract FDI in Africa are tourism, natural resource industries, and industries for which the domestic market is important, such as telecommunications (UNCTAD, 2002a). However, the sectoral diversification is encouraging given that it encompasses agriculture and labor-intensive manufacturing – the two sectors that provide the backbone of most African economies and hence can make the greatest contribution to poverty reduction.

Mode of Entry

Since the mid-1980s, cross-border mergers, strategic alliances and acquisitions have been the means used by multi-national corporations to enter foreign markets. Cross-border mergers occur when two companies of almost equal sizes come together under common ownership. Strategic alliances take place when two companies come together for the purpose of accessing each other's strategic assets (particularly new technology). Acquisitions, on the other hand, are undertaken when bigger companies take over smaller ones and are one of the quickest ways of entering a new market (Bende-Nabende, 2002).

There is some indication of an increase in the proportion of acquisitions in the last decade as opposed to Greenfield investment, in line with world trends. M&A transactions increased from an annual average of $0.6 billion in 1990-1994 to over $2.5 billion in 1995-1999 and $7.5 billion in 2000-2003[11] (UNCTAD, 2005). However, this may be a temporary phenomenon as foreign firms take advantage of privatization programs, which necessarily draw-in foreign capital via acquisition. Acquisitions were rampant from 1990 to 1999 and tended to occur in the primary sector. Greenfield investment continues to play an important role and is particularly visible in the service sector. Other types of FDI witnessed in the past decade have been participation in a joint venture and licensing.

The mode of entry is important to analyze as it may influence the extent to which the host country benefits from the presence of foreign owned firms. The World Investment Report 2000 explores many of the concerns associated with the impact of

[11] This represents 16, 30 and 54 percent of total FDI flows, respectively.

acquisitions by foreign companies in developing countries. It concludes that, in the short term, acquisitions may have fewer benefits (or larger costs) than Greenfield investment for the host country. This conclusion is driven by the view that acquisitions do not necessarily add to productive capacity in contrast to Greenfield investment where aggregate economic activity necessarily increases (UNCTAD, 2000).

5. Workers' Remittances

Finally, workers' remittances – fundamentally viewed as cash and non-cash transfers to households back home by people working away from their origin communities – are now a recognized source of development finance. Most of Africa has been hit by brain drain as professionals have immigrated to other countries in search of greener pastures. While the brain drain has largely had a negative effect on the development of Africa, the remittances sent by the same have reached significant figures to merit the attention of policy makers. In fact, remittances are becoming of scholarly debate in recent years, with the main focus being reversing the negative impacts of the brain drain.

The 2005 Global Development Finance Report estimates that remittances reached $126 billion in 2004 and continued to show an upward trend. Indeed, the latest report from the same source revises this figure upwards to $161 billion for 2004 and pegs them at $167 billion for 2005. Remittances seem to be unique in that they appear more evenly distributed and less volatile than the rest of the capital flows to developing countries. Table 6, extracted from the 2005 Global Development Finance Report, documents some aggregate figures. The figures suggest that Africa is tailing other regions. Nevertheless, the report acknowledges the shortcoming of these figures which take into consideration remittances channeled via official systems. One would argue that for Africa, it is very plausible that an equal or greater amount is channeled via informal means.

Table 6: Worker's remittances to developing countries, 1990- 2004 ($ billions)

	1990	1995	2000	2001	2002	2003	2004e
Developing Countries	31.3	56.7	76.8	84.6	99.0	116.0	125.8
Lower middle-income	17.5	34.8	41.9	44.1	49.1	54.8	55.6
Upper middle-income	5.7	8.6	13.1	18.8	18.7	24.4	26.8
Low income	8.1	13.3	21.7	23.8	31.2	36.7	43.4
Latin America and the Caribbean	5.8	13.4	20.2	24.2	28.1	34.1	36.9
South Asia	5.6	10.0	16.0	16.0	22.3	26.7	32.7
East Asia and the Pacific	3.2	9.0	11.2	12.9	16.6	19.5	20.3
Middle East and North Africa	11.7	13.0	13.5	15.2	15.5	16.8	17.0
Europe and Central Asia	3.2	8.1	11.0	11.4	11.5	12.8	12.9
Sub-Saharan Africa	1.9	3.2	4.9	4.9	5.1	6.0	6.1

Source: *IMF Balance of Payments Statistics Yearbook 2004 and World Bank estimates cited by Global Development Finance 2005. Note: e = Estimate*

Unfortunately, a scarcity of data prohibits further breakdown of these remittances by country. However, anecdotal evidence and results from households' surveys carried out in many African countries point to the importance and increased inflow of remittances. A recent survey article on Zimbabwe shows remittances from Zimbabweans in the Diaspora to be contributing immensely to the livelihood of those left behind in the rapidly shrinking economy[12]. To date, millions of Africans have left their countries in search of greener pastures so the potential benefits these remittances could bring to their respective economies could enormous. As it is, remittances are associated with boosts in human capital as immigrants are investing in education, entrepreneurship and health of their loved ones. It is therefore important that governments find means of proper channeling and encouraging this type of capital.

[12] http://www.gprg.org/pubs/workingpapers/pdfs/gprg-wps-045.pdf

6. Conclusion

This paper has documented trends in capital flows with particular emphasis on the volume and structure of FDI in Africa. Three types of flows of significance to Africa are official development assistance, foreign direct investment and workers remittances. By their nature, they offer African economies some intrinsic advantages for economic development. In contrast to all other developing regions, Africa has remained aid-dependent and a marginal recipient of FDI and workers' remittances. As such, African countries still need to explore factors limiting FDI and remittances flows while using the official assistance they are still receiving to create an investment friendly environment. One plausible use of official assistance would be in laying sound infrastructure key for attracting FDI.

A distinct feature of FDI flows to Africa is their sectoral bias towards natural resource extraction,[13] which does not offer much development benefit for Africa. To minimize potential adverse effects of such investments, African governments must demand that MNCs investing in their countries follow international environmental guidelines. Regarding the emerging South-South flows, Africa needs to be effective in collecting good data on all aspects of this investment to allow empirical analysis to inform appropriate policy responses. Last but not least, governments in Africa should think hard about how to channel worker remittances to boost their foreign currency reserves. Incentives need to be put in place for Africans in the Diaspora to channel their remittances through formal systems and ensuring that such capital is used for investment purposes as opposed to consumption. This naturally requires strengthening of financial

[13] This trend, however, is being altered by increased South-South flows.

systems and macroeconomic stability, particularly controlling inflation. Such efforts could counter the brain drain as well as generate a steady stream of foreign exchange.

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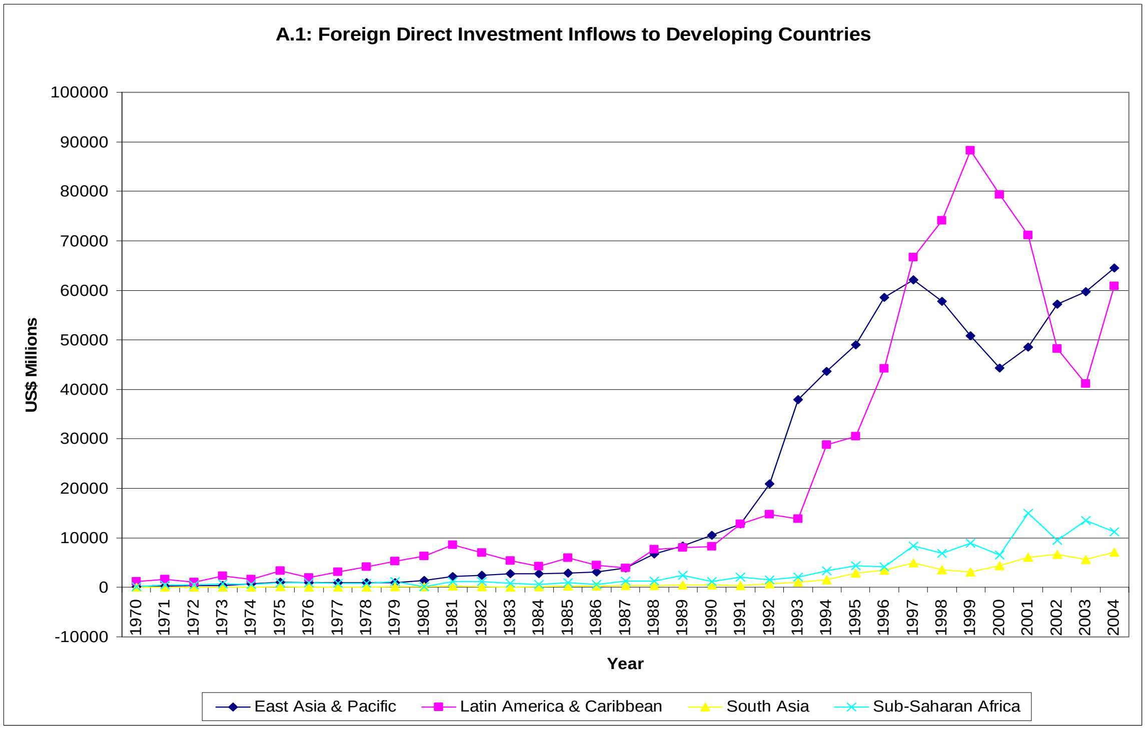
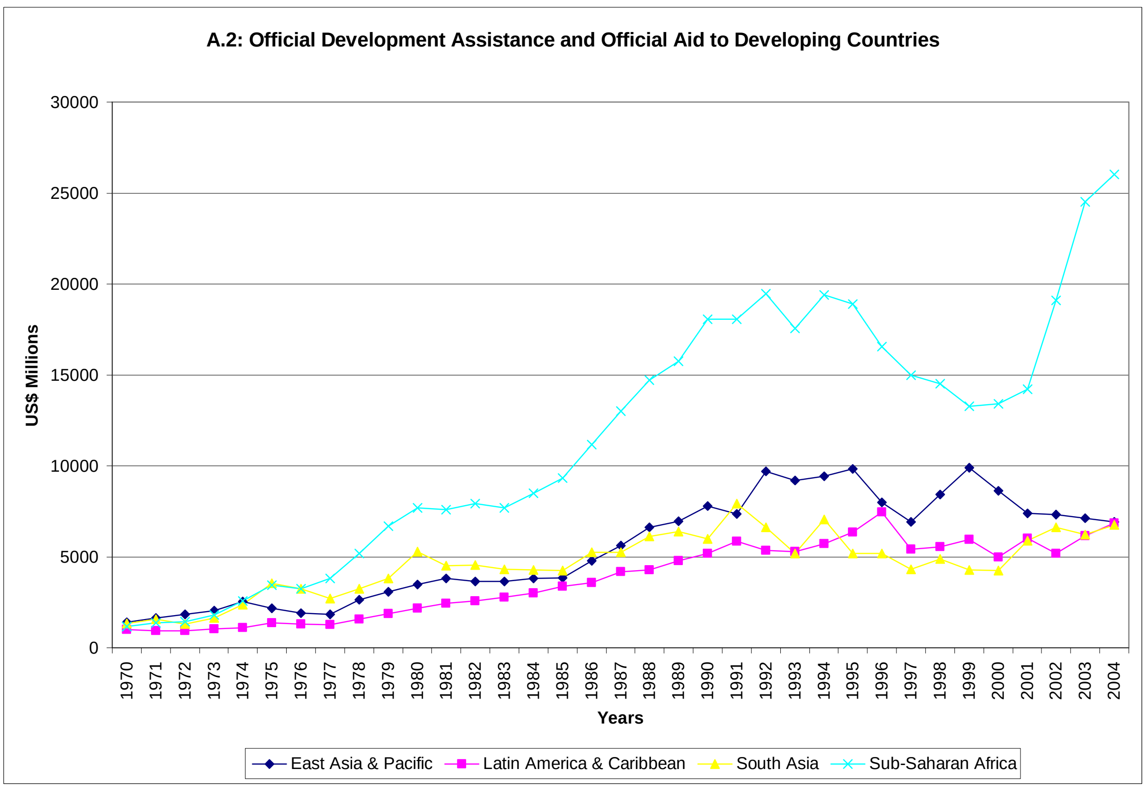
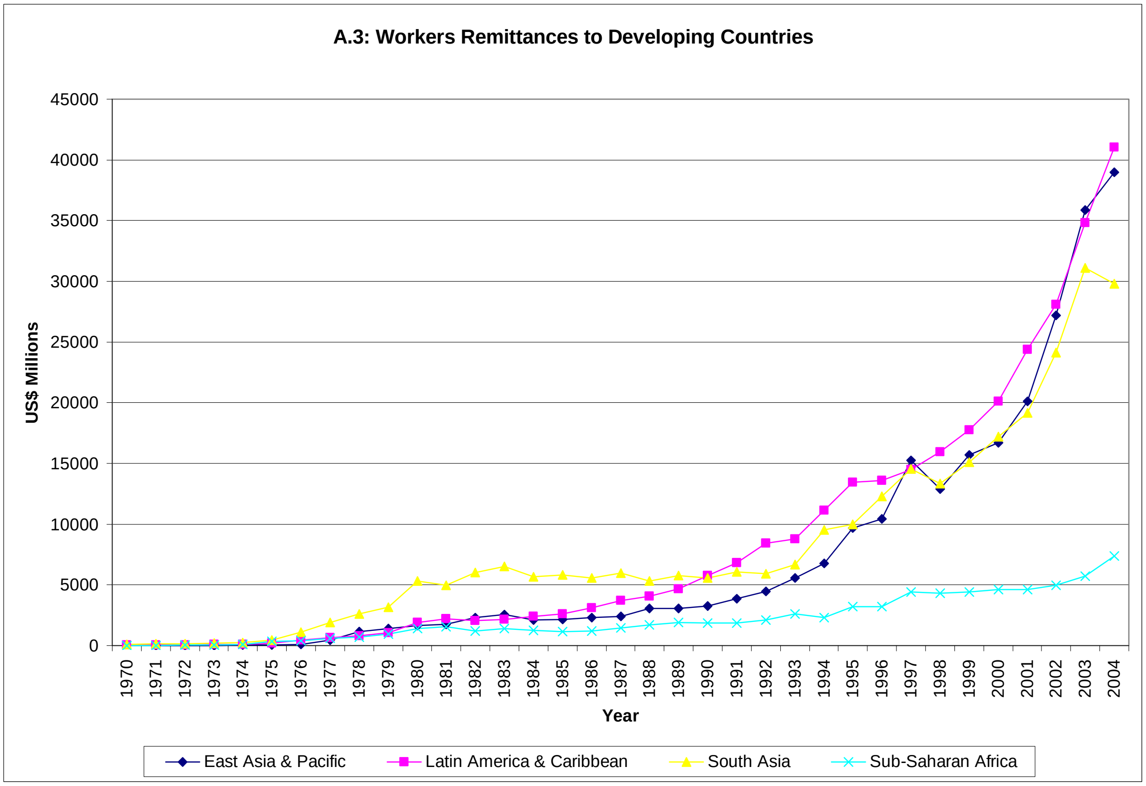
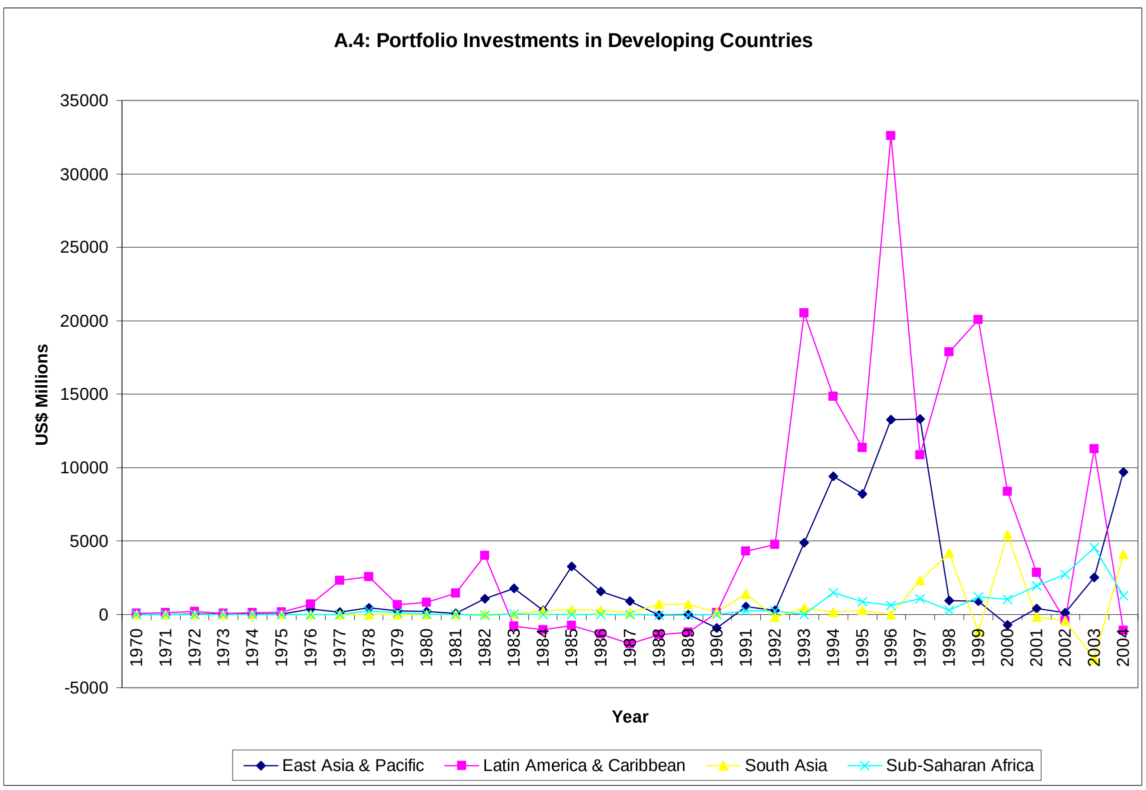
Appendix

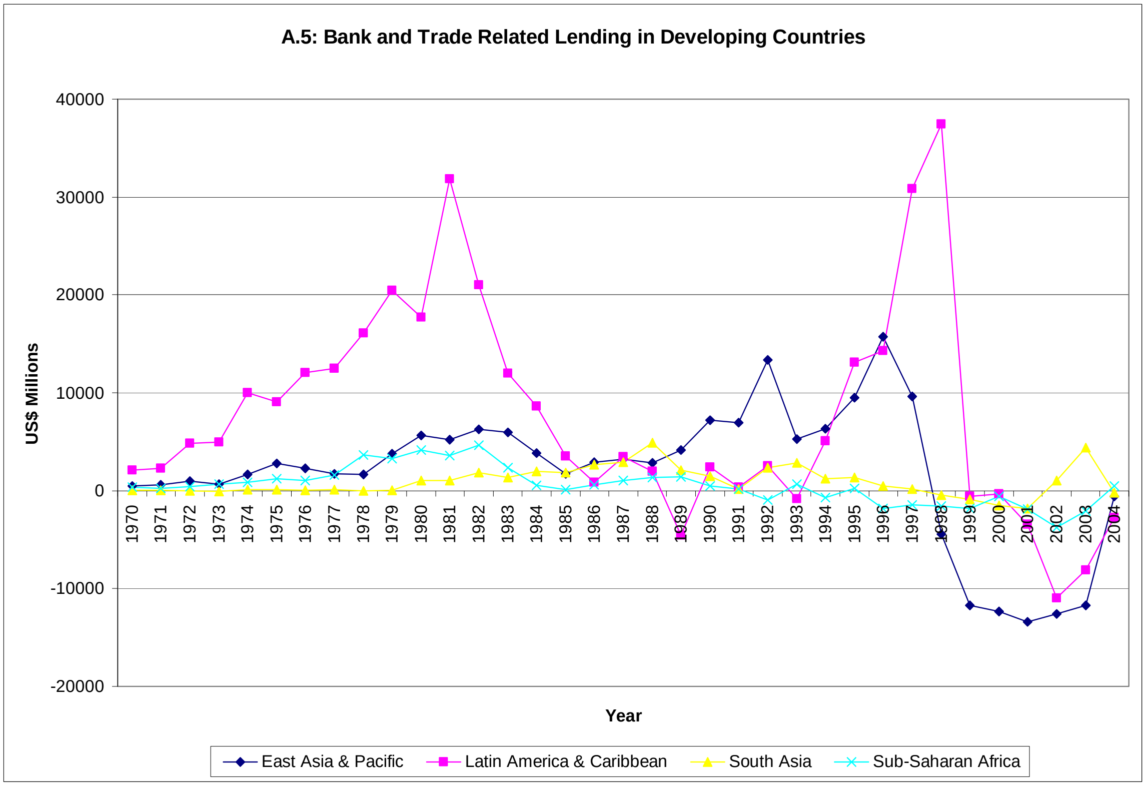
Source: All charts created from data from World Development Indicators

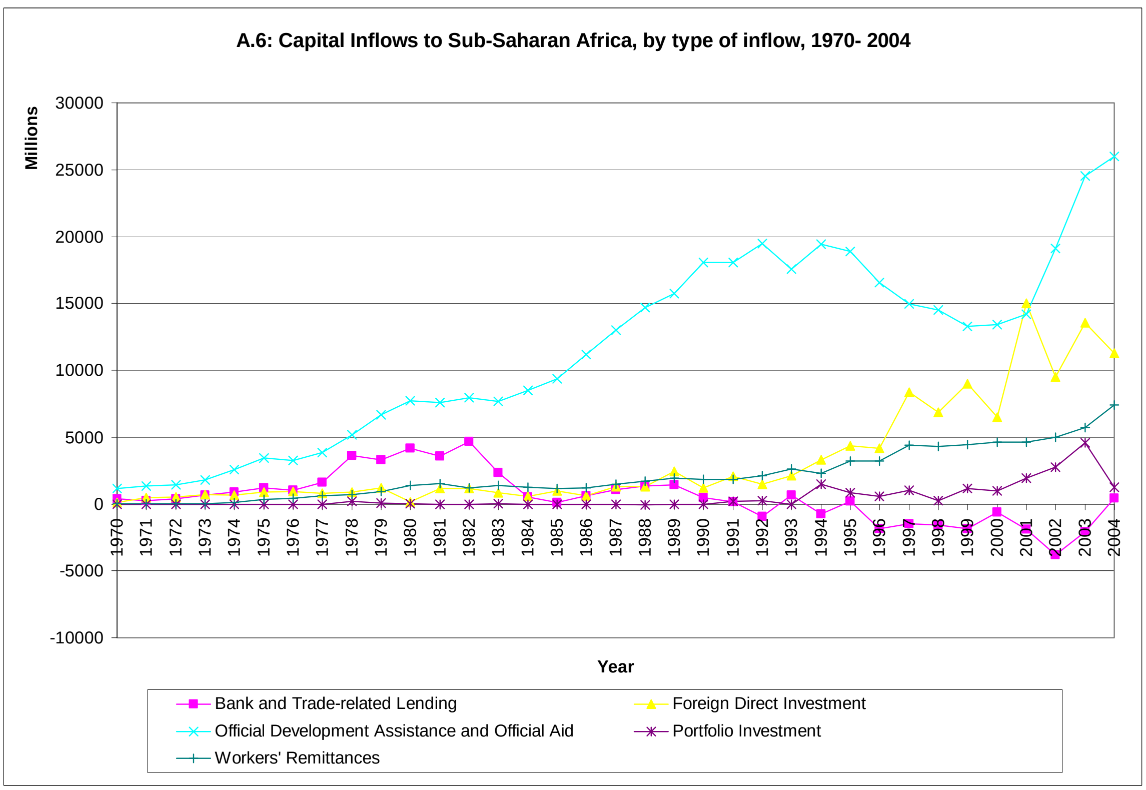





A.3: Workers Remittances to Developing Countries
US$ Millions
45000
40000
35000
30000
25000
20000
15000
10000
5000
0
1970 1971 1972 1973 1974 1975 1976 1977 1978 1979 1980 1981 1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004
Year
East Asia & Pacific
Latin America & Caribbean
South Asia
Sub-Saharan Africa


A.4: Portfolio Investments in Developing Countries
US$ Millions
35000
30000
25000
20000
15000
10000
5000
0
-5000
1970 1971 1972 1973 1974 1975 1976 1977 1978 1979 1980 1981 1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004
Year
East Asia & Pacific
Latin America & Caribbean
South Asia
Sub-Saharan Africa


A.5: Bank and Trade Related Lending in Developing Countries
US$ Millions
40000
30000
20000
10000
0
-10000
-20000
1970 1971 1972 1973 1974 1975 1976 1977 1978 1979 1980 1981 1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004
Year
East Asia & Pacific
Latin America & Caribbean
South Asia
Sub-Saharan Africa


A.6: Capital Inflows to Sub-Saharan Africa, by type of inflow, 1970- 2004
Millions
30000
25000
20000
15000
10000
5000
0
-5000
-10000
1970 1971 1972 1973 1974 1975 1976 1977 1978 1979 1980 1981 1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004
Year
Bank and Trade-related Lending
Foreign Direct Investment
Official Development Assistance and Official Aid
Portfolio Investment
Workers' Remittances

Definitions: World Development Indicators

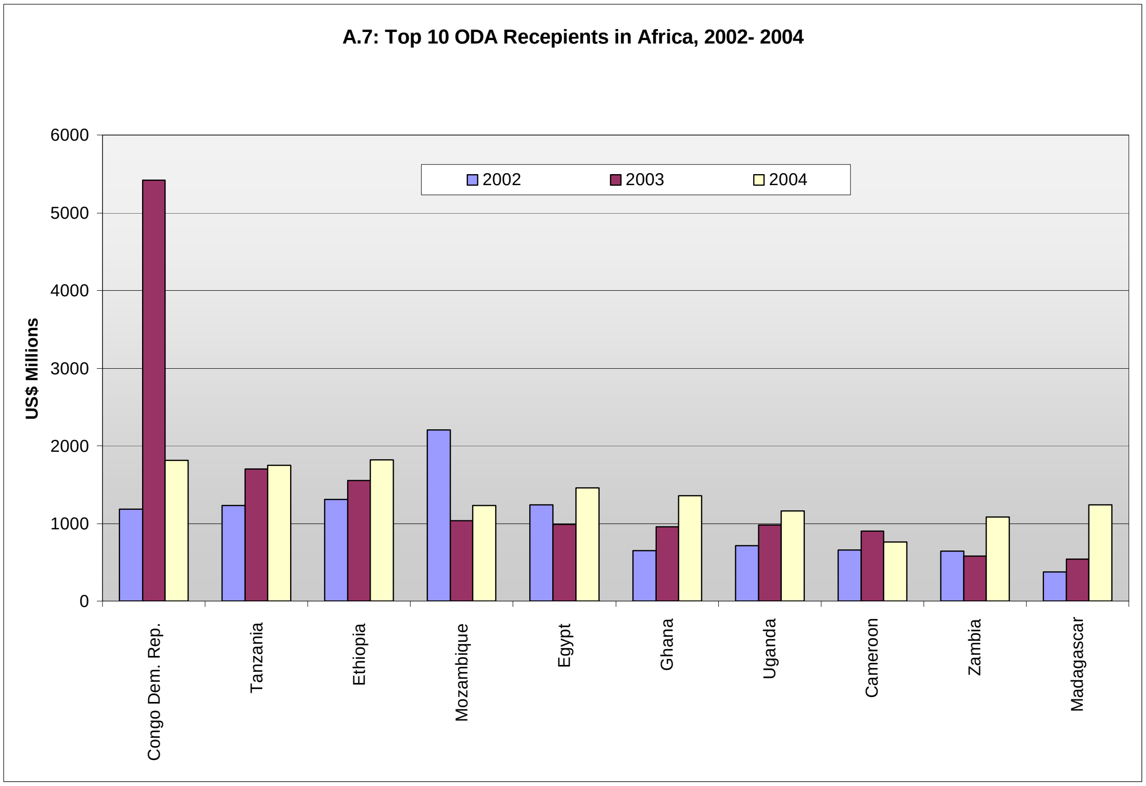
Bank and trade-related lending (PPG + PNG) (NFL, current US$): Bank and trade-related lending covers commercial bank lending and other private credits. Data are in current U.S. dollars.

Foreign direct investment, net inflows (BoP, current US$): Foreign direct investment are the net inflows of investment to acquire a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor. It is the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital as shown in the balance of payments. This series shows net inflows in the reporting economy. Data are in current U.S. dollars.

Official development assistance and official aid (current US$): Net official development assistance consists of disbursements of loans made on concessional terms (net of repayments of principal) and grants by official agencies of the members of the Development Assistance Committee (DAC), by multilateral institutions, and by non-DAC countries to promote economic development and welfare in countries and territories in part I of the DAC list of recipients. It includes loans with a grant element of at least 25 percent (calculated at a rate of discount of 10 percent). Net official aid refers to aid flows (net of repayments) from official donors to countries and territories in part II of the DAC list of recipients: more advanced countries of Central and Eastern Europe, the countries of the former Soviet Union, and certain advanced developing countries and territories. Official aid is provided under terms and conditions similar to those for ODA. Data are in current U.S. dollars.

Portfolio investment, bonds (PPG + PNG) (NFL, current US$): Portfolio bond investment consists of bond issues purchased by foreign investors. Data are in current U.S. dollars.

Workers' remittances and compensation of employees, received (US$): Workers' remittances and compensation of employees, received comprise current transfers by migrant workers and wages and salaries earned by nonresident workers. Data are in current U.S. dollars.



Source: OECD Statistics, www.oecd.org/dac/stats/regioncharts

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