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South-South Investment: The Case of Africa

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This chapter focuses on South-South foreign direct investment (FDI), particularly as it relates to Africa, on which there has been very little analysis to date. The EDGE Institute is starting a research project on this issue, so that this chapter will reflect some of the initial thinking and background work done to get the project underway rather than detailed research.

Over the last 10 years there has been a very rapid increase in South-South FDI. FDI inflows to developing countries increased nearly four-fold, from an annual average of just over \$54 billion in the 1985-95 decade to over \$200 billion between 1998 and 2003. At the same time, FDI outflows from developing countries rose from \$12 billion in 1991 to a peak of \$99 billion in 2000, with the average outflow from developing economies being \$61 billion between 1998 and 2003. (UNCTAD, 2004) However, South-South flows have grown far faster than North-South flows. One recent estimate suggests that "South-South" flows rose from \$4.6 billion in 1994 to an average of \$54.4 billion between 1997 and 2000, equivalent to 36 percent of total FDI inflows to developing economies in the latter period (Aykut and Ratha, 2004).

Foreign Investment into Africa

FDI flows into Africa from other developing countries have increased as part of this broader trend, with two major sources. The first has been Asia. A recent World Bank report on Africa's economic links with Asia is one of the few that addresses South-South FDI (World Bank, 2004).

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It indicates a massive increase in investment from China into sub-Saharan Africa 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. Only about twenty percent of that amount came into South Africa, not as large a share as might have been expected. 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. In value terms, extractive and resource-related projects comprise a much higher share at 28 percent, but nonetheless 64 percent of the value of Chinese investment in Africa is in the manufacturing sector.

Taiwan has also been a major source of FDI into Africa. There was a substantial wave of Taiwanese investment into South Africa during the 1980s, but more recently, particularly in response to the African Growth and Opportunities Act (AGOA) passed in the US in the late 1990s, Taiwanese investment has entered several other Southern and East African countries. There are now as many as 700 Taiwanese investment projects throughout sub-Saharan Africa.

The third Asian country which is rapidly growing in importance as an investment source in Africa is India. In South Africa there has been a very rapid move by Indian conglomerates into a range of sectors, both services (IT, banking) as well as manufacturing, including automotive, steel and pharmaceuticals. There are now estimated to be 35 Indian companies present in South Africa, but probably double that number in terms of projects.

Much less investment is coming into Africa from Latin America, although Brazilian firms are now starting to move quite actively into the other Lusophone countries in Africa, Angola and Mozambique in particular.

The second major source of South-South investment into the rest of Africa is South Africa itself. Since the advent of democracy in 1994, there has been a very rapid movement of South African firms throughout the continent. A press clipping count of investment projects done at The EDGE Institute in mid-2004, about a year ago, yielded over 600 projects by South African firms in the rest of Africa. The number of projects provides a useful indicator of the very rapid and extensive move into Africa by South African companies. Their sectoral distribution is also interesting: about 15 percent of these projects were in mining, very few in agriculture, and only about 20 percent in manufacturing. The vast majority were in service industries: in utilities, hospitality and tourism, construction, IT and banking.

Market-Seeking and Resource-Seeking Investment

Why is there this rapid increase in South-South FDI? The process can be examined using the basic distinction between market-seeking and resource-seeking investment common in analysis of FDI. In broad terms, the entry of South African and Indian companies into Africa is largely market-seeking, and has been driven by the liberalisation of regulations and lowering of entry barriers in the host countries. This applies also to inward FDI coming into South Africa from industrialised countries during the past 10 years, and to firms which were present in South Africa under apartheid but have expanded their operations in South Africa to use it as a base for exporting to the rest of sub-Saharan Africa (Gelb and Black, 2004).

The second thrust of South-South FDI into Africa is resource-seeking, and this characteristic is much more prominent in Chinese and Taiwanese investment. "Resource-seeking" should be taken to mean not only extractive industries such as mining or agriculture, but also to include the quest for cheap labour as a resource. The latter has become increasingly important as a result of AGOA. In this case, it is not host country liberalisation that is enabling and encouraging foreign investment, but rather trade access – firms are coming to Africa seeking resources, either for export back to their home markets or for processing in Africa for export onto third markets, with the US particularly important in the clothing and textile sectors.

What does this entry of foreign investors from other developing countries mean for Africa economic development? One of the key issues that needs to be addressed for African development in general (taking account of differences amongst countries) is improving governance, defined in broad terms as reducing the risk elements in the investment climate and promoting human capital resources and their accumulation. A related constraint on development is the weakness, and in some cases complete absence, of a domestic business class in many African economies. An important question that we should be posing in relation to the balance of costs and benefits of FDI in Africa is about its contribution to promoting the activities of domestic business, and increase the supply of entrepreneurs. In this regard, one can again make a distinction between market-seeking and resource-seeking foreign investment.

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The former offers much more potential in terms of promoting forward and backward linkages and in terms of impacting on competition in the domestic market, though the latter effect might be negative. Market-seeking FDI is likely to increase the scope and quality of goods and services that are available to domestic firms and households as inputs into production and consumption. In contrast, resource-seeking investment (especially producers seeking cheap labour) is more likely to have some impact on employment promotion and exports, with some possible impact on the transfer into the host economy of technology and new business models and on establishing or improving productive infrastructure.

The Advantages of South-South Investments

Do South-South investments differ from North-South investments, and if so, how? Ten years ago, Yeung (1994) argued that "developing country TNCs are a special species of the capitalist beast – they are more beneficial to the host economy than other TNCs from developed countries." We can hypothesise that market-seeking firms in manufacturing, in utilities and services are more likely to provide accessible goods and services to domestic firms and households, if the supplying firm comes from another developing economies than from an industrialised economy. *A priori*, South-South investment is also more likely to make use of distribution and business network models that will not only lead to more successful entry for the foreign firm, but also more effectively promote backward and forward linkages within the domestic economy and therefore support domestic enterprise development. With limited "absorptive capacity" in the host economy to adopt new technologies and innovate, the smaller "technology gap" between domestic firms and foreign investors firms from other developing countries enhances the possibility of technological spillovers via FDI. Resource-seeking investments have different advantages: one that is often understated is that these investments, particularly from Asia, often increase the supply of entrepreneurs through immigration. Asian firms tend to use large numbers of expatriate managers and supervisors in their foreign investments, and these individuals often leave their employers to set up their own firms in the economies where they find themselves. The greater prospects offered abroad are an incentive for aspiring entrepreneurs from China, Taiwan or India to move from their home countries, where their opportunities are more limited.

Another important advantage of South-South resource-seeking investments is that they embody business models which are less corporatised and more informal than western models, and are often more appropriate to the host country context. As a result, learning and spillovers to the domestic economy are possible, though local business culture may limit the latter's absorptive capacity in this regard. More generally, investors from developing countries, including some of the South African corporations moving into Africa, tend to be less risk-averse and more willing to deal with the informal governance arrangements and processes found in many African economies in relation to distribution of goods and services, security issues and so on.

At the same time, they are perhaps more likely to press for improved governance and infrastructure to lower their risk, than investors from industrialised countries, who would more likely choose not to enter in the first place, or to exit if they find themselves in a situation where risks have increased substantially. The experience of Lesotho is interesting in this regard. As a result of AGOA there has been very rapid growth of the textile and clothing industry as a result of Asian firms entering, to the point where the sector now contributes a huge share of overall output. What we are seeing now is a process of growth leading infrastructure as Chinese and Taiwanese investors demand improved infrastructure in transport, energy and water, all necessary for profitable operations in the sector. As a result, the government is beginning to address these issues with the help of the donors.

While one does not want to overstate the potential for foreign direct investment from "the South" to promote development in the host economy, in theory it is possible that both resource- and market-seeking FDI can have a positive impact. Whether these benefits are in fact achieved has not been empirically demonstrated. The EDGE Institute's project will investigate this, by collecting firm-level data in South Africa, India, Kenya, Tanzania and Uganda to assess the development impact in *both* host and home economies of FDI flows between these countries. The quote from Yeung above also refers to specific characteristics of the investing firm, underlining the need to assess the *home* economy impact of South-South FDI flows as well. In this regard, we can hypothesise that the benefits may vary according to the destination of the FDI.

The rise in South-South investment into sub-Saharan Africa will not automatically change the terms of the relationship between Africa and "the North" (industrialised countries) in the short-term. But it can

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provide individual governments in Africa with greater bargaining power in their relations with multinational corporations from industrial countries and foreign investors more generally, precisely because it diversifies the host countries' options, and so gives their governments more bargaining power. To the extent that it contributes to the creation of a strong and domestic business class and other development processes, over the long run it may contribute to changing the power balance.

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