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Acronyms

ACP	:	Africa-Caribbean-Pacific
ACS	:	Association of Caribbean States
BOI		Board of Investment
BIT	:	Bilateral Investment Treat
CARICOM	:	Caribbean Community and Common Market
CBI	:	Cross-Border Initiative
CEMAC	:	Comunauté Economique et Monetaire d'Afrique Centrale
CMA	:	Common Monetary Area
COMESA	:	Common Market for Eastern and Southern Africa
EPA		Economic Partnership Agreement
EPZ		Export Processing Zone
ECOWAS	:	Economic Community of West African States (cf. UEMOA)
FDI		Foreign Direct Investment
HDI		Human Development Indicators (UNDP)
HIPC	:	Heavily Indebted Poor Countries
IMF	:	International Monetary Fund
IOC		Indian Ocean Committee
IOR-ARC		Indian Ocean Rim - Association for Regional Co-operation
IT	:	Information Technology
LDC	:	Least Developed Countries
MAI	:	Multilateral Agreement for Investment
NGO	:	Non-Governmental Organisation
OECD	:	Organisation for Economic Co-operation and Development
SACU	:	Southern African Custom Union
SADC	:	Southern African Development Co-operation
TNCs	:	Trans-National Corporations
UEMOA		Union Économique et Monétaire Ouest-Africaine (cf. ECOWAS)
UNCTAD	:	United Nations Conference on Trade and Development
UNDP	:	United Nations Development Programme
WAEMU	:	West African Economic and Monetary Union
WDI		World Development Indicators (World Bank Statistical Annex)
WTO	:	World Trade Organisation

EXECUTIVE SUMMARY

Introduction

1. The report analyses the main critical factors linked to the impact of *foreign direct investment* (FDI) in developing countries, with particular emphasis on the *Least Developed Countries* (LDCs). The effect of inward investment in these countries touches on a wide range of issues, both in terms of approach to the *problem of development* and *policy strategy.*

2. The main issues examined in the study are the following:

   - To which extent FDI contributes to *growth* and *poverty reduction* targets while improving the financial capacities of the developing countries to ease the *debt burden*;
   - To which extent the transnational corporations' (TNC) business strategies generate *negative impacts and distortions* in the host economies, taking advantage of the fact that the poorly developed legal framework cannot always enforce necessary restrictions on such actions: how can sustainable development be pursued under these difficult legal conditions;
   - Which are the main *barriers and shortcomings* in the host countries that can affect the impact of FDI on raising the level of skills, know-how and technology and limit possible FDI *spill-over* effects on the economy;
   - How the developing countries can *take advantage of the globalisation process,* taking into consideration the *intensification of competition*, and which policies could be most appropriate in enhancing *capacity building* and *domestic governance* to create more favourable conditions for *attraction of FDI*;
   - How *geographical proximity* and *regional integration* – through regional agreements – can contribute to an acceleration of economic growth, representing a way to ease the impact of world market integration that accompanies the progressive lifting of trade and investment barriers;
   - Which are the *roles of the international organisations* in addressing such issues and which are their current approaches: which challenges are on the “agenda” for the future.

3. In addressing these issues, the study provides policy recommendations that – in the context of the ongoing programmes of the international organisations and donors (World Bank, International Monetary Fund, UNDP, European Union) – identify some possible steps that can be taken in order to improve the effectiveness of policies to attract higher quality FDI in developing countries.

The approach to development and poverty reduction: new issues and linkages with inward investments

4. The persistence of poverty and social distress in the Developing Countries, and in particular in the Least Developed Countries (LDCs), raises *theoretical and practical (policy)* questions about the causes and the processes that are behind the exclusion from the "benefits" of globalisation. The difficulties in inducing a process of sustained catching-up, as other geographical areas (for example East Asia) have shown in past decades, and the perpetuation of *policy failure*, either *government failure* or *market failure*, raise the issue of rethinking the *strategy of development* (Meier, G.M., and Stiglitz, J.E., 2001). The necessity to clarify the approach to the *problem of development* is essential in understanding the difficulties and distortions that hinder the "*potential beneficial role*" played by foreign direct investment (FDI), which is one of the pillars of the process of internationalisation and integration into the world market together with *trade liberalisation* and *access to information flows*. The marginalisation of the LDCs in international flows, which include not only capital, but also technology, knowledge and information, has to be understood as the result of two different phenomena:

   (i) The *low degree of integration into the world economy*, keeping the DC at the margins of globalisation;

   (ii) The *poor quality of this limited integration*, mainly dominated by *unfavourable specialisation*, resulting from both legacies of past economic history and more recent *monoculture* profiles, strongly linked to exploitation of natural and mineral resource endowments, sometimes by the TNCs.

5. The more recently evolved approach to *development* emphasises that *growth "per se"* is not enough (Yusuf, S., and Stiglitz, J.E., 2001; World Bank, 2001), despite being *a* sine-qua-non condition. This is because development also depends on the *quality of factors* and mutual *linkages,* not only of a *tangible nature*, such as capital investment, but also on *intangible factors* that comprise an integral part of the *"social capital"* of the society, such as *institutional capability*, *cumulated knowledge* and all of the elements that contribute to a *favourable business environment*: a pro-business and effective legal framework, private-public partnership, co-operation, networking, and innovation capacity (World Bank "Social Capital Initiative"). In the developing countries, and especially in the LDCs, *social fragmentation*, the identification with traditional community groups that prevails over the "*notion of nation"*, and the weak social and political credibility of the governments make the concept of "*social capital*" a very ambiguous and difficult concept with which to identify (Collier, P.,1998; and Coleman, J.S., 1990). These social and cultural weaknesses, combined with serious gaps in the legal framework, make up the often contradictory business environment in which the interests of world market competitiveness and the strategies of the dominant TNCs sometimes collide dramatically.

6. *Institutional capacity* is one the most critical factors emphasised within the new approach to development in pursuing a strategy conducive to investment, while at the same time beneficial to the host countries' people. Institutional factors are also decisive in contributing to an improvement in *attractiveness to FDI* by inducing productivity gains. The most critical implications of the institutional framework in this regard are the following:

(i) *stability of the political system* within the host country: a lack of governments in power that enjoy widespread social support makes developing countries very unstable and the business environment very insecure;

(ii) *government capacity and commitment* to establishing and imposing transparent regulations which affect business operations that are also respected by foreign investors: the weakness of most governments in policy implementation also strongly affects their bargaining capacity within their country and even more at the international level;

(iii) *social unrest and endemic ethnic conflicts* have led to security problems that affect both current and potential domestic and foreign business operations: over the past decade (1990s), some 18 developing countries, 10 of which are among the 32 lowest-income countries, have experienced war and internal conflicts (World Bank, 2001).

7. Behind this new approach to development there is a changed understanding of the *process of world economic integration* and the *contribution of inward capital investment to growth.* The contribution of FDI to economic growth can be highly relevant, but its actual effects depend on a multiplicity of factors that are related to both:

   (i) the *quality and scope of the inward investments;*

   (ii) the *domestic conditions conducive to investment* in the host country.

8. Thus the effects of FDI on growth depend not only on the *capital returns* over the short term, but more fundamentally on the *direct and indirect linkages* established between the inward contribution and the local economy. A *lack of relevant linkages* leads to only a limited effect on development, mainly associated with raw material export earnings or "creation of small islands of development", bringing about "*dual effects*" with a lack of integration between a "fortunate" sector linked to foreign investment activities (mainly related to raw materials) and the isolated indigenous economy. Without substantial *spillover* effects, FDI does not induce growth and over the long term, erodes the development perspective.

9. The contribution of FDI to growth in developing countries is directly related to a combination of different factors related to the type and form of investment. A small amount and low quality of FDI (in terms of limited sectoral importance, often concentrating on the primary sector, especially as seen in Africa) on the one hand, coupled with local institutional instability, armed conflicts, violence and security threats, poor management capacity, non-transparent legal conditions and inadequately skilled local labour, make it very difficult to create the "basic conditions" under which to develop a more favourable business environment to induce further investment and counteract the "*vicious cycle*" of *cause and effect*.

10. In the same perspective, the definition of *poverty* has profoundly changed. It is not only the *level of income per capita* that indicates the poverty of a country, but also other related *social and cultural indicators* that must complete the picture. Because development is the result of a complex set of factors, such as education, life expectancy, level of technology and skills of the labour force, as well as institutional capability, the notion of poverty has acquired a wider meaning. Poverty is the consequence of a negative combination of a wide range of economic, social and

institutional factors (OECD, 2001; UNDP, 2000; World Bank, 2001): this is why, in attempting to provide some measure of the level of poverty, it is necessary to include different indicators, covering the entire range of economic and social aspects.

The problem of macro-economic imbalances and the impact of the debt burden: the HIPC initiative

11. Financial crises and the increase in the debt burden of the developing countries have had a direct negative impact on FDI flows, since the financial unreliability of these nations may increase uncertainty for investors and may also contribute to political instability in those host countries that are heavily affected, in particular the LDCs. The recently instituted *Heavily Indebted Poor Countries (HIPC)* initiative has been proposed jointly by the IMF and World Bank to 33 LDCs that qualify for the initiative in order to excuse or progressively reduce their debt. The approach behind the HIPC is comprehensive and co-ordinated and aims also at the improvement of the institutional capacity to manage the debt and the public policies related to the budgetary and financial matters. At the same time, there is a need to improve the *sustainability of financial rehabilitation* with other related reforms accompanying debt reduction: should such an effort not be undertaken, the reasons for the accumulation of debt in the first place would rapidly reproduce the *vicious cycle* of the "*debt trap*". However, the HIPC does appear to have some shortcomings, such as an excessive enforcement of conditionality, narrow criteria for eligibility to the initiative, and a too limited amount of debt relief (UNCTAD; 2001). Furthermore in 2001, only very few countries were able to fully adhere to the scheme, limiting *de facto* the potential beneficial impacts on financial conditions in these countries.

The contribution of FDI in Developing Countries: its role and impact

12. The role of FDI could be beneficial in developing countries primarily from a macro-economic perspective, contributing to capital formation in domestic economies that suffer from a shortage of capital and savings (UNCTAD, 1999). However, the lack of substantial positive linkages can diminish substantially the macro-economic multiplier effects in the host economy and can also lead to distortions in economic development linked to FDI "specialisation" patterns.

13. Over the past decade, world FDI flows have increased dramatically, growing more rapidly than trade, but within this trend, the developing countries have experienced mixed results. Since the beginning of the 1980s, developing countries as a whole have benefited from a significant increase in total FDI flows, mainly green-field investments [1]: between 1991and 1997 FDI flows have even exceeded trade flows in terms of exports and imports (UNCTAD, 1999). Yet there are great disparities between FDI results in the different geographic areas, Latin America, Asia and Africa.

[1] FDI in developing countries and in particular in Africa tends to be green-field investments rather than the result of mergers and acquisitions (M&A): this pattern can be easily explained in Africa by the fact that the investments are mainly related to the exploitation of local resources and only rarely to the acquisition of African companies, given the still limited degree of industrialisation and the small size of the domestic market.

14. Africa, in particular, has experienced a dramatic and very rapid erosion of its attractiveness to foreign investors. When comparing the results over the long period between 1970 and 1997, Africa has lagged significantly behind Latin America and the Caribbean, as well as South and East Asia. While at the beginning of the 1970s, Africa attracted more FDI per US$1000 of GDP than any of the other continents – mainly because of the growing interest in the exploitation of its natural resources and raw materials – its deteriorating macro-economic conditions and the proliferation of conflict and social unrest led to a sharp decline in FDI, particularly since the 1980s. During the 1990s, despite the rapid increase in the total volume of FDI in the world, Africa has experienced a further decline in its share of the total: total FDI flows to Africa in 2000 accounted for only 1% of world FDI inflows (in 1999 its shares of world trade were 1.6% of exports and 1.9% of imports). The very small share of Africa in global investment flows, despite representing 12.2% of the world's population (World Bank, 2000), shows its very marginal role within the globalisation process.

15. The most relevant features of FDI flows in developing countries in general and Africa in particular are the following:

- While there has been an overall global slowdown of FDI flows to Africa, there has also been a marked trend toward a *concentration of FDI in a few countries*, reflecting the general tendency toward "concentration of production" (UNCTAD, 2001a). The few "*front runner*" countries like Ghana, Egypt, Botswana, Tunisia, Namibia, Equatorial Guinea, and Mozambique. However, at the same time, this polarisation of FDI indicates that the diffusion of the gains from global integration are still very limited, accompanied by a further dramatic decrease in the weight of LDCs in the global economy, leading to their increasing marginalisation and in turn deeper recession and aggravation of the poverty spiral.

- The dominant sectoral patterns of FDI show some interesting, though limited, changes: over the past two decades, the leading role played by investments in natural resources and raw materials exploitation has declined sharply: between 1988 and 1998 the inward stock dedicated to the primary sector for all developing countries shrank by half (UNCTAD, 1999). This shift in sectoral patterns was linked to the increasing weight of manufacturing and services, particularly tourism, in FDI. While in Africa the primary sector, mining in particular, still accounts for the dominant share of FDI, there are some tentative signs of evolution toward more diversified patterns. Furthermore, it needs to be emphasised that the sectoral analysis of FDI corroborates the evident interest of TNCs in establishing strong sectoral specialisations in the host countries in order to benefit from the implicit externalities that these specialisations would necessarily imply (in particular in the *Free Economic Zones* these linkages become very explicit) in terms of related services and also a certain level of sectoral skills that the local labour resources will have acquired. In addition, it seems that when there is greater diversification in the size of foreign companies, away from TNCs, for example toward medium-sized firms, there are also relatively more diversified activities in services or tourism or low value-added manufacturing: experiences in Egypt, Tunisia, Ghana and Mauritius, for example, confirm the emergence of these positive patterns. The increasing

number of medium sized company investors - while their relative weight remains limited in comparison with that of multinational companies - indicates a favourable trend that could bring about an encouraging increase in a more friendly type of investment. At the same time, the creation of joint ventures between foreign and local companies is also improving: often the foreign companies come from other, more advanced developing countries (*South-South investments*) or can be also affiliates of TNCs, in those cases where the latter pursues a strategy of developing linkages with local companies as sub-contractors.

16. The lack of *backward linkages* substantially limits the multiplier effects on the local economy in maximising the positive impact that FDI brings to the host country (UNCTAD, 2001). As mentioned above, high-quality FDI and suitable local conditions are both necessary for inducing positive spin-off effects. To facilitate such spill-over effects in the local economy, the investing companies, especially TNCs, need to involve local suppliers (in particular SMEs) in those cases where sectoral activities foresee a partial or substantial share of re-investment from the proceeds of the foreign investment operation in the country in order to increase local value-added.

17. Among the additional factors that limit attraction of FDI and hinder the creation of positive linkages between FDI and the host country economies are the following:

    (i) *Limited dimension of local markets* both in terms of population and its low purchasing power: thus regional integration among neighbouring countries can be beneficial in expanding market dimensions;

    (ii) The chronic *inadequacy of infrastructure,* which suffers from serious gaps in terms of physical capacity (f.e.: transport; telecommunications structures) and in effectiveness of operation (power, public services, communications, etc.) that impede easy and safe physical access to markets and also ease communications with peripheral regions;

    (iii) The *insufficiency of the regulatory framework for foreign business operations*: ineffective or non-existent regulatory measures, and legislation governing foreign assets, repatriation of capital returns, taxation and trade policy. This is aggravated by institutional inability or unwillingness to enforce them;

    (iv) *High transaction costs* due to corruption, excessive administrative requirements and inefficiency of public administrations in particular in dealing with business.

18. Furthermore, the level of *capital return from inward investments* is not always sufficient to encourage such investments in the developing countries. On the contrary, the significant capital returns in Africa, in particular, seem to be linked to the TNCs' focus on basic strategic targets, that are not necessarily considered a reason for attraction of further investments. In fact, the high profits generated by TNC investments in developing countries are very seldom reinvested in the host countries, but are mostly repatriated or channelled though their branch operations.

19. Supporting this consideration, the high *capital return* on investments of North American TNCs, particularly in the primary sector in Africa, would suggest that this incredibly high return (twice that in the secondary sector) is the result of very intensive exploitation of basic resources, a low level of respect of safety and technical regulations in the employment of local labour, a lack of competition from domestic companies in the local market, lax fiscal enforcement and corruption of local governments ready to comply with the requirements imposed by the TNCs: these high returns could be considered a kind of *"monetarisation"* of "*country risk*", in particular in situations where conflict or indigenous violence raise the level of danger to company operations. All of these negative factors that affect current business operations in many developing countries have become highly remunerative opportunities for those TNCs that operate in sectors that have serious environmental or health impacts on human resources, taking advantage of the poorly developed institutional framework and enforcement capacity. The issue of TNC "*social responsibility*" is now at the forefront of the international debate on globalisation and sustainable development.

Sustainable growth and the problem of the environment

20. The necessity to establish close linkages between *development and protection of the environment* is recognised by all donors and international organisations (World Bank, 2000d; OECD, 2001; UNCTAD, 2001) as an imperative requirement for ensuring the improvement of the economic and social welfare of populations while respecting environmental conditions to safeguard human health and preserve natural resources for future generations. *Sustainable development strategy* translates this broad objective into concrete actions, which, in their implementation, require a *strong complementarity among the different sectoral policies*: the strong interdependence of each policy element linked to the poverty reduction strategy, including the improvement of the business climate and living conditions of the people, as well as efforts to combat social marginalisation, highlight the difficulties and complexities that underlie such objectives. The fact that there is no unanimous approach to the extent to which rules have to be applied to ensure public safety, in particular in developing countries, the level of discretionary decision-making remains very high: this is indeed a very controversial issue in which different approaches give rise to evident trade-offs and also conflicts of interest.

Trade and Investments: the effect of multilateral and regional agreements

21. The relationship between trade liberalisation and growth is becoming increasingly evident (OECD, 2001): the improvement of the export capacity of developing countries could increase their ability to earn and reinvest in the domestic economy, favouring infrastructure development and in turn creating better conditions for attraction of FDI, thus initiating a process of economic recovery. Due to their economies' dependence on exports, especially of primary products (minerals, timber and agricultural products) and/or simple manufactured goods (for example textiles), developing countries would benefit significantly if the present barriers to trade in the developed countries were to be lifted (UNCTAD, 1998; OECD, 1999 and 2001, World Bank, 2001). At the same time, the developing countries themselves maintain even higher trade barriers, de facto limiting South-South trade flows.

22. Empirical findings (Hertel, T.W, et al., 2000) confirm that for particular products, such as some industrial products like textiles and clothing, but especially agriculture, trade tariff barriers are still significant, while the average tariffs for most commodities have been substantially reduced due to the effects of preferential treatment as in the case of the EU vis-à-vis ACP countries (Africa-Caribbean-Pacific) under the Lomé Convention and the subsequent Cotonou Agreement. The share of agricultural products exports[2] from developing countries in the imports of developed countries (Europe, North America, Japan) remains quite small: in 2000 such trade represented only 10% of total imports (for the EU alone it was only around 3%) and less than 1/5 of actual total exports of agriculture products by the developing countries to the world. The maintenance of a high level of subsidies to agriculture, for instance in the USA and the EU [3], certainly represents a factor that hinders the capacity of developing countries to improve their export penetration potential and limits their economic gains (World Bank, 2001b; OECD, 2001b; UNDP, 2000).

23. The GATT negotiations under the Uruguay Round have led to a significant improvement in the regulations against unfair practices. In previous decades, GATT policies had left far too much discretion to national governments in the adoption of trade and competition rules. The necessity to reach a trade agreement with a higher level of transparency and unambiguity and in particular a capacity for its effective enforcement was a founding principle in the establishment of the World Trade Organisation ("WTO") in 1995. The new WTO also called for a stronger policy implementation commitment of all members. In particular, the rules that have to be enforced by new members are significantly more rigorous than they were several decades ago. These tighter constraints will also have a greater direct impact on the domestic reform agendas of the new members of the WTO, as China confirms. This suggests that speeding up the processes aimed at improvement of competition and economic restructuring (including privatisation) in order to strengthen the performance of the private sector, will in turn provide a powerful incentive for further FDI attraction.

24. In May 1995, the OECD made an attempt to elaborate a comprehensive multilateral framework for international investment with the proposed *"Multilateral Agreement on Investment"* ("MAI"). The MAI was conceived as a "free-standing" [4] instrument providing new bases for pursuing further liberalisation of investment regimes, offering investment protection to investors with effective dispute settlement procedures. However, the bases on which the Agreement was proposed were not comprehensive enough in terms of investor obligations toward the host countries. A

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[2] For agricultural products such as meat, sugar, cocoa and chocolate, milk, dairy products, tobacco, fruits and vegetables, the tariffs vary from 100% to 180%, but can also reach 132% to 550% for groundnuts in Japan and the USA. For the food industry, the tariffs are generally in excess of 30% (World Bank, 2001b).

[3] The EU initiative *"Everything but Arms"* is focused on permitting free access for all type of LDC exports, excluding armaments. This initiative will be introduced through the modification of the *Generalised System of Preference* (GSP). However, for sugar and rice, the full liberalisation will be postponed until 2009, due to the sensitivity of the internal European market to imports of these two products.

[4] Open to all OECD members and non-members.

large number of European countries and several developing countries [5] disagreed on issues regarding rights to entry and establishment, criticising the too permissive and one-sided rules. The major beneficiaries of this initial proposed framework would have been the TNCs, which, taking into consideration the lax “code of conduct for TNCs” of a non-binding nature, would have gained higher guarantees without clear obligations vis-à-vis the host countries. Eventually, the MAI was abandoned in 1998 due to the impossibility of reaching a coherent agreement on this large set of issues.

25. The failure of these attempts to directly address at an international level the standard rules for investment protection and investor and host country obligations has increased the pressure on the WTO to make progress in the elaboration of more adapted instruments that address investment and competition matters and promote closer linkages between external policy regulations, involving trade and foreign investment, and domestic policies. In this respect, the July 2001 the WTO Doha Conference represents a step forward, both in providing for more coherent implementation of the Uruguay Round provisions and in highlighting the importance of other provisions linked to investment, such as the Trade-Related Aspects of Property Rights (TRIPs), Plurilateral Agreement on Government procurement (treatment of foreign enterprises and protection of certain property rights), the Agreement on Trade-related Investment Measures (TRIMs) and the Agreement on Subsidies and Countervailing Measures (ASCM): all of these agreements directly and indirectly address certain fields of operation and attraction of foreign investment, in particular those related to trade liberalisation.

The Cotonou Agreement and its innovative approach to poverty reduction and market integration: the search for linkages

26. The Cotonou Agreement between the EU and the ACP [6] countries represents one of the most coherent and innovative approaches to poverty reduction, sustaining the progressive integration of developing countries into the world economy. The Cotonou Agreement is not solely a trade agreement but has a comprehensive nature, covering the different components that are essential for the progressive improvement in the ACP countries' ability to deal with the problems of development and integration, effectively replacing the previous Lomé Conventions that were negotiated under conditions that have profoundly changed over the past few decades. The enhancement of trade relations therefore needs to be more coherently linked to developments in other policy fields that the developing countries need to address in facing the tremendous challenges of globalisation and increasing competition.

The regional agreements: highly differentiated levels of integration

27. The increasing interest in regional integration was reawakened due to a number of reasons:

- As demonstrated in several successful cases in different regions of the world, regional agreements have proven to be a strong catalyst for the improvement of

[5] In February 2002, the OECD has disclosed the MAI documentation and reports – omitting, however, mention of the different country opinions, related to OECD Ministerial committees held during the negotiation period that ended in 1998.
[6] Of the 78 countries comprising the ACP, 40 countries are LDCs, including most of the 49 LDCs in the world.

competitiveness based on progressive lowering of trade and investment barriers vis-à-vis neighbouring countries, thus helping to facilitate industrialisation and regional market integration;

- The principle of "proximity" of markets is not based purely on geographic criteria, but also has broad cultural and historical implications, thus making the process of integration much easier than an individual country might achieve in the world market;
- Given the small size of the domestic markets of most developing countries, in particular African nations, regional agreements facilitate the creation of much larger market outlets, with possible improvement in the allocation of resources: the capacity to attract FDI would also improve, because the emergence of a regional market could reinforce a more advantageous allocation of labour resources and specialisation within the regional area. The TNCs have, in fact, encouraged these trends, since they will be better able to exploit the comparative advantages of closer regional integration in their global de-localisation and specialisation strategies. There are several cases where the TNCs have favoured the creation of regional country network, promoting deeper specialisation of their affiliates or sub-contractor companies (that might also be joint ventures), located in the different countries of the region: one good example is Toyota's strategy in the East Asian region;
- The process of regional integration also could facilitate technology and financial transfer between the neighbouring countries, combined with greater ease of diffusion of information on market opportunities, technology and innovation;
- Furthermore, regional agreements could facilitate the development of required infrastructure and transport linkages, especially those with a cross-border relevance, improving the mobility of factors and goods.

28. The WTO Doha Conference addressed the issue of coexistence of regional and multilateral agreements, especially in matters regarding investment: it has been emphasised that many regional agreements go beyond the WTO rules, thus there could be room for positive integration, but also raises the possibility of sharp inconsistency, especially with regard to the "rules of origin" (which imply protection measures) and "labour mobility" (where there can be highly differentiated approaches). In fact, the extent of trade, monetary and economic integration within the regional agreements (whether as a free trade area, customs union, single market, currency union, or other type of arrangement), varies significantly, depending also on the historical and cultural background, especially the colonial heritage. Integration is the leading principle behind most of these arrangements, but is not always coherently pursued.

29. Among the African countries, probably the most successful and relevant regional agreements are the following, though their levels of integration vary and some of them have uncertain futures: ECOWAS (West Africa), UEMOA (the former French Franc zone in West Africa, that has also achieved monetary union), CEMAC (the French Central African countries), COMESA (Eastern and Southern African States), and SACU (Southern African Customs Union).

30. There are a number of important issues regarding the shortcomings of the regional agreements:

    - The participation of individual countries in different regional groupings (sometime they are members in two or three and even more different arrangements) can create *overlaps and problems in harmonisation* of discordant levels of trade liberalisation, sometimes leading to *trade diversion effects* (WTO, 2001). "*A la carte*" integration (OECD, 2002) could lead to incompatibility with general WTO rules, in particular concerning the benefits associated with "*preferential treatment*", resulting in broad disparities in individual case treatment and significant distortions in trade among the countries involved;
    - The *level of complexity of individual regional agreements* (WTO, 2000 and 2001) represents a further administrative burden and higher transaction costs for the still generally weak institutional management capacities of these countries in contrast with the more concentrated and simplified efforts within the multilateral negotiations under the WTO or other relevant agreements, such as Cotonou;
    - Despite great expectations for the regional agreements, it has become evident that the increase in *intra-regional trade* within the grouping, especially in Africa, has not been always as significant as initially foreseen and in some cases has even decreased since 1990 (World Bank, 2000). Besides the high trade barriers that are still in force in many cases, the main obstacle to full exploitation of the favourable conditions presented by market proximity is the still *limited potential for complementarities*, because of *unfavourable economic specialisation*, mainly concentrated on raw materials and agriculture (OECD, 2002);
    - The still *limited development of intra-regional communications, transport and physical infrastructure* in general: the investments required to establish and improve these capacities are very substantial and there are serious gaps in the financial resources available for such major projects in the regions.

The enforcement of regulatory bases for TNCs and their "social responsibility"

31. The central role played by the transnational corporations (TNCs) in the process of globalisation has raised the complex issue of the "*social responsibility*" that these firms bear when they operate in developing countries. The social responsibility of corporations is a subject that has been treated since the 1970s in the *international codes of conduct*. However, it has always been a controversial issue between the different economic and institutional players in both the TNC country of origin and the host countries, in particular the developing countries. This is why, up to the present, the most recent elaboration of Guidelines for TNCs by the OECD has only had a *voluntary* character and not a binding nature (OECD, 2001a, 2001b).

32. The OECD elaboration underlines the importance of the efforts that need to be made to improve the relationship between "business" (i.e. the TNCs) and the (host) society: *corporate responsibility* implies the interest of the TNCs in improving the social and economic conditions in the host countries where they operate: in the best cases, the interests of the large corporations would coincide with the interests of the society, also providing positive results for the TNCs, in improving the general conditions in the markets where they operate over the short-term as well as from a long term perspective. An *ethical* approach, if in some cases seeming to corroborate

the global strategy of the TNCs, can bring about an upgrading of local production factors (for example, human resources), creating employment and favouring some technology transfer, while at the same time respecting the environment; however, such an approach remains confined to isolated cases that cannot be generalised.

33. The main critical issues that are included in the "*social responsibility*" chapter are the following:
    - (i) *Environmental issues*: these are among the most sensitive for the developing countries, because of the dominant sectoral specialisation either in mining, logging, plantation agriculture or petrochemicals, which have a direct impact on the environment;
    - (ii) *Labour safety problems:* with the predominance of investment in the primary sectors, especially mining, there is a strong need to elaborate strict *labour safety rules and health standards* that need to be applied in local business operations;
    - (iii) *Human rights and basic labour standards and conditions* (ILO, 1998) need to be respected by the TNCs, taking into consideration the cultural and social background of local communities from which the labour resources come;
    - (iv) *Information disclosure*: the often monopolistic position of the TNCs in host country markets leads to the emergence of *de facto* barriers to information and access to knowledge about all aspects of the TNC's operations and products;
    - (v) *Anti-corruption*: Poverty, institutional weaknesses and the lack of an institutional framework conducive to business have created an environment in which corruption is endemic;
    - (vi) *Consumer protection*: despite the low level of civil society debate and awareness of food safety and consumer protection in host countries, TNCs need to address the problem on their own.

34. It is evident that these rules touch on a wide range of different fields of actions and imply complex linkages among policies (UNCTAD, 2001). Among the most critical policy fields addressed are the following:

    - (i) *Competition*: competition policy is the primary field in which the regulations for the TNCs need to be effective, limiting the possible abuse of their dominant position (control of markets and prices) vis-à-vis domestic companies by creating *de facto* internal barriers that hinder competition and limit access to the domestic market;
    - (ii) *Taxation*: This is a relevant financial issue for the host country authorities so that they can compel TNCs to pay fiscal obligations where they operate and prevent their avoidance of taxation through the unfair practice of "transfer-pricing";
    - (iii) *Transfer pricing*: This is a practice that is very diffused among TNCs, which effect direct transfers between their own affiliates located throughout the world, without declaring revenues in the host countries: through transfer pricing, most if not all profits are sent to other locations (country of mother firm or other affiliates), having the dual effect of circumventing fiscal duties and limiting substantially further investment;

(iv) *Technology and knowledge transfer*: the TNCs could induce positive effects in upgrading the technology, skill and knowledge levels of local labour resources and easing access to "*socially useful technology*"[7] (UNCTAD, 2001), taking into consideration the educational and social background of the host country;

(v) *Development obligations* are the most controversial issue because of the wide-reaching implications: While the other practices can be well defined in terms of legal and economic legislation associated with them, " *development obligations*" depend on a very strategic approach of the TNCs defining obligations and responsibilities toward the society and economy in which they invest.

International donor strategy addressing the structural issues

35. International aid can have positive multiplier effects only if sound reform policies are put into place within the host countries. Aid should not subsidise activities, but provide a boost to dynamic programmes for improving economic activities. Thus aid should aim at improving the quality of the factors, whether labour resources, institutional capacity, and public policy formulation and regulation, but should not substitute the local actors, either public or private. There is growing agreement among international organisations (World Bank, European Union, UNCTAD, UNDP, World Trade Organisation, etc.) in recognising the importance of the shift from the traditional "aid support"– which did not always induce improvement of the local factors in stimulating growth, but often perpetuated the passive behaviour of the local government and population in "relying on external aid" – toward more active agreements that encourage the pursuit of reforms inside the country, helping to create more endogenous capacities, thus improving the conditions for investment attraction capacity including FDI.

The case-studies: Mauritius, Madagascar and Ghana – the specificity and lessons to be learnt

36. The countries selected for the case studies are Mauritius, Madagascar and Ghana. These choices provide an opportunity to investigate a variety of different conditions that have affected the FDI experience within the ACP: all three have made important recent changes in their policies toward FDI and are in or located near Africa.

- **Mauritius** followed a path of development linked to particularities of its situation as a small island state. With its specific conditions (limited land area and natural resources, small population size and large distance from main export markets), it represents an interesting case in which government policy strongly committed toward sustaining development has allowed it to achieve a relatively high per capita income and become a lower-middle income country. Mauritius has selected a unique path which aims at promoting the country's transition to an "*intelligent"* island with an economy oriented towards a *high value base*. Since the 1970s it has diversified from a mono-crop industry to an industrial economy

[7] The notion of *"socially useful technology"* refers to technology that responds to the needs of the host countries, considering the specificity of their social structure and skill levels.

and is now developing higher value added sectors: IT and offshore financial services as well as tourism. The challenge for Mauritius will be to sustain this development path in the face of global economic slowdown, while at the same time maintaining its greatest natural resource: the natural beauty of the environment;

- **Madagascar** represents a very poor country with a pro-business policy and significantly under-exploited potential. The country furthermore has a unique and highly vulnerable natural environment that could be irreparably damaged by certain types of investment. Despite promising potential for economic development based on plentiful natural resources, particular geographic location and abundant labour resources, Madagascar has not been able to secure sufficient FDI to allow the economy to take off and effectively combat poverty. This represents quite an interesting contrast to Mauritius, which in the 1970s had few comparative advantages and was able to raise itself to lower middle-income status. Madagascar has not yet been able to follow the path of sustainable growth; however, the economic indicators of the past three years suggest that the country's economy is improving and that FDI is increasing;

- **Ghana** represents a resource-rich country that has undergone important macro-economic reform programmes (including liberalisation of trade and investment regimes) and has achieved some positive results in macroeconomic performance, improving the business environment in general as well as its policies toward extraction activities. The attempt to shift away from *traditional primary resource-based exports* toward *non-traditional sectors* has not been completely successful. Efforts to develop activities with greater added value, in particular cocoa and wood-processing, have not yet reached sustainable levels and the country must increasingly compete for investment with other African countries that have recently instituted very aggressive investment-attraction policies. The new Government has a difficult task ahead in trying to stabilise its macroeconomic development following a serious decline in the terms of trade and growing debt.

Conclusions: Policy Recommendations

37. FDI has tremendous potential to improve opportunities for developing countries to take advantage of globalisation trends by improving the quality of factors of production and establishing linkages with other markets. However, this process is hampered by a multitude of structural economic and institutional impediments and regulatory deficiencies, both domestically (in the host countries) and at the international level. The increasing marginalisation of the LDCs reflects the failure of poverty reduction strategies in past decades, as well as the limited contribution of FDI to the development process: the shift in the strategic approach to poverty reduction in recent years has not yet been translated into measurable effects, because of the severity and complexity of the situation in many of the countries.

38. The close relationship between a country's capacity to attract and absorb investment, domestic economic and social conditions and institutional capacity confirms that FDI *per se* cannot bring about the expected multiplier effects in the host country economy in the absence of suitable economic framework or a sufficiently effective

regulatory framework, facilitating further positive links with the local economy. On the other hand, the investment strategies led by TNCs are not always concerned with the upgrading of local resources and improving conditions in the host countries: the problem of international arbitration is still an imperative open issue.

39. In this respect there are two critical issues that reflect the dramatic changes that characterise the current phase of globalisation:

    (a) The increasing *gap* between the pace of globalisation of investments and flows of information, technology and goods and the capacity of institutions and international organisations to regulate these flows requires a strategic rethinking of approach: the difficulties in implementing and enforcing standard rules to regulate and govern the complexity of material (capital and goods) and intangible flows (information, knowledge, skill, management capacity, etc.) make it far more difficult for developing countries that have little bargaining power to improve their marginal role in global economic integration. The need for international organisations to play an innovative and more powerful regulatory role is one of the main challenges for the future;

    (b) The necessity for *more co-ordinated and effective delivery of aid and technical assistance* by the international organisations, in co-operation with the wealthiest developed countries in order to offset their relative decline in development expenditures. Overlapping, competing and sometime diverging policy approaches have narrowed the overall effectiveness of aid provision from the different sources. The recent trend toward more co-ordinated and common initiatives marks a positive change that requires further progress in order to maximise the aid efforts and gaining better value for the money spent;

40. The analysis developed in this report emphasises that there is a clear need to address the issue of *public policy effectiveness* and *linkages between the different policy fields*.

    The following issues need to be examined in greater detail:

    - Despite the failure of the MAI to establish international rules for FDI, such an effort needs to be once again undertaken, though this time with more emphasis on consensus-building between the international organisations and involving representatives from the developing countries. There is much room for initiatives at the international level which have not received enough attention and commitment from the major players;
    - The issues related to the *"social responsibility*" of the TNCs comprise an integral part of this package. An *international code of conduct* regarding rules *imposed on TNCs* (and other investors) needs to establish coherent linkages between the latter and the *Multilateral Agreements*: specific problems related to investment activities in the Developing Countries need to be addressed, while favouring the progressive consolidation of stricter legal regulations. Voluntary (non-binding) rules are not sufficient in many cases, especially when there is no willingness on the part of the TNC to support socially responsible investment activities in the host country;

- The *level of trade liberalisation* in the developed countries, while having improved considerably over recent years, is not yet sufficient to allow developing countries to significantly improve their market access: the dramatic decline of their exports over the past few years confirms this unfavourable trend. The implementation of WTO rules still needs to be fully and more broadly enforced. At the same time, in order to overcome non-tariff trade barriers, there is a clear requirement to improve the skill capacity of developing country public administrations in order to put into place effective *quality standard monitoring and technical certifications capacities* to apply the rigorous consumer safety and phyto-sanitary standards on the basis of developed countries consumer market principles: this could also improve export capacity and competitiveness in accessing these markets;
- Improving the *transfer of information technology* (IT), with particular attention to social and cultural brackets of the population that could become potential small business operators (like young people or women), can assist in the upgrading of the business environment in general, reinforcing the capacity to attract FDI. The international organisations need to address the still substantial obstacles to more diffused utilisation of IT, also because the investment costs for such technologies are relatively low in comparison with the benefits that could be gained without requiring high skills. However, basic infrastructure development would have to be undertaken; for example, for Internet use the telephone system would need to be improved, especially in remote rural areas;
- There is a necessity to promote *diversification of FDI activities*, taking into consideration the specificities of the economic and social background of the host countries: while targeted campaigns to encourage investment in particular sectors and activities are present in the investment attraction efforts of some of the more advanced developing countries, an approach focusing on the " *development obligations*" of the TNCs has been called too optimistic. Yet channelling the investment activities of the TNCs into new areas that would help the improve host countries' capacities to diversify their economies would support greater development efforts. It is necessary to support the application of a *broader investment strategy* by TNCs in order to establish linkages with the host country to facilitate the *creation of SMEs* associated with the main sector of foreign investment, thus favouring the emergence of potential *backward linkages* with local entrepreneurs as subcontractors. By introducing more *value-added activities,* without requiring very high skills and utilising "development friendly technology", could help upgrade the level of knowledge and ability of local labour resources, in turn boosting new private sector development in the manufacturing as well as services;
- It also could be desirable to *promote more diversification in the types of foreign investors from developed countries*: in particular, it could be beneficial to encourage companies other than TNCs, in particular *SMEs,* to invest in developing countries and engage in more development-favourable and locally based investments that are better adapted to the conditions there. At the same time, the higher level of *country and commercial risk* for such investors needs to be addressed, because of the lower capacity of the SMEs to assume such risks in an isolated manner. In this perspective, joint initiatives could be developed to work out more tailored schemes for FDI promotion together with those ACP governments that are politically more stable and co-operative;

- As articulated within the Cotonou Agreement, the importance the *regional groupings* could be enhanced. Technical assistance focused on the improvement of the capacities of their inter-regional regulatory and trade systems could be of great significance and have a very positive impact in lowering those barriers to the flow of goods and investments that still hinder closer economic integration. The improvement of the capacity to enforce trade and investment regulations would also facilitate the further development of the relationship between the EU and the ACP countries, creating better conditions and mutual understanding for future economic agreements.

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INTRODUCTION

The Report analyses the main critical factors linked to the impact of *foreign direct investment* (FDI) in developing countries, with particular emphasis on the *Least Developed Countries* (LDCs). The effect of inward investment in these countries touches on a wide range of issues, both in terms of approach to the problem of development and policy strategy.

The main issues that are examined in the study are the following:

- To which extent FDI contributes to *growth* and *poverty reduction* targets while improving the financial capacities of the developing countries to ease the *debt burden*;
- To which extent the transnational corporations' (TNC) business strategies generate *negative impacts and distortions* in the host economies, taking advantage of the fact that the poorly developed legal framework cannot always enforce necessary restrictions on such actions: how can sustainable development be pursued under these difficult legal conditions;
- Which are the main *barriers and shortcomings* in the host countries that can affect the impact of FDI on raising the level of skills, know-how and technology and limit possible FDI spill-over effects on the economy;
- How the developing countries can *take advantage of the globalisation process*, taking into consideration the *intensification of competition*, and which policies could be most appropriate in enhancing *capacity building* and *domestic governance* to create more favourable conditions for *attraction of FDI*;
- How *geographical proximity* and *regional integration* – through regional agreements – can contribute to an acceleration of economic growth, representing a way to ease the impact of world market integration that accompanies the progressive lifting of trade and investment barriers;
- Which are the *roles of the international organisations* in addressing such issues and which are their current approaches: which challenges are on the "agenda" for the future.

In addressing these issues, the study provides policy recommendations that – in the context of the ongoing programmes of the international organisations and donors (World Bank, International Monetary Fund, UNDP, European Union) – identify some possible steps that can be taken in order to improve the effectiveness of policies to attract higher quality FDI in developing countries.

1. BACKGROUND: THE PROBLEMS OF DEVELOPMENT AND POVERTY REDUCTION

1.1. The approach to development and poverty reduction: new issues and linkages with inward investments

The persistence of poverty and social distress in the Developing Countries, and in particular in the Least Developed Countries (LDCs), raises theoretical and practical (policy) questions about the causes and the processes that are behind the exclusion from the "benefits" of globalisation. The difficulties in inducing a process of sustained catching-up, as other geographical areas (for example East Asia) have shown in past decades, and the perpetuation of *policy failure*, either *government failure* or *market failure*, raise the issue of rethinking the *strategy of development*.

The necessity to clarify the approach to the problem of development is essential in understanding the difficulties and distortions that hinder the "*potential beneficial role*" played by foreign direct investment (FDI), which is one of the pillars of the process of internationalisation and integration into the world market together with *trade liberalisation* and *access to information flows*. The marginalisation of the DCs in international flows, which include not only capital, but also technology, knowledge and information, has to be understood as the result of two different phenomena:

(i) The *low degree of integration into the world economy*, keeping the DC at the margins of globalisation;
(ii) The *poor quality of this limited integration*, mainly dominated by *unfavourable specialisation*, resulting from both legacies of past economic history and more recent *monoculture* profiles, strongly linked to exploitation of natural and mineral resource endowments, sometimes by the TNCs.

The more recently evolved approach to development emphasises that growth "per se" is not enough (Yusuf, S., and Stiglitz, J.E., 2001; World Bank), despite being a sine-qua-non condition. This is because development also depends on the *quality of factors* and mutual *linkages,* not only of a *tangible nature*, such as capital investment, but also on *intangible factors* that comprise an integral part of the *"social capital"* of the society, such as *institutional capability*, *cumulated knowledge* and all of the elements that contribute to a *favourable business environment*: a pro-business and effective legal framework, private-public partnership, co-operation, networking, and innovation capacity (World Bank, "Social Capital Initiative"). In the developing countries, and especially in the LDCs, *social fragmentation*, the identification with traditional community groups that prevails over the "*notion of nation"*, and the weak social and political credibility of the governments make the concept of "*social capital*" a very ambiguous and difficult concept with which to identify (Collier, P., 1988; Coleman, J.R., 1990). These social and cultural weaknesses, combined with serious gaps in the legal framework, make up the often contradictory business environment in which the interests of world market competitiveness and the strategies of the dominant TNCs sometimes collide dramatically.

Institutional capacity is one the most critical factors emphasised within the new approach to development in pursuing a strategy conductive to investment, while at the same time beneficial to the host countries' people. Institutional factors are also decisive in contributing to an improvement in *attractiveness to FDI* by inducing productivity gains. The most critical implications of the institutional framework in this regard are the following:

(i) *stability of the political system* within the host country: a lack of governments in power that enjoy widespread social support makes developing countries very unstable and the business environment very insecure;
(iii) *government capacity and commitment* to establishing and imposing transparent regulations that affect business operations that are also respected by foreign investors: the weakness of most governments in policy implementation certainly also strongly affects their bargaining capacity within their country and even more at the international level;
(iii) *social unrest and endemic ethnic conflicts* have led to security problems that affect both current and potential domestic and foreign business operations: over the past decade (1990s), some 18 developing countries, 10 of which are among the 32 lowest-income countries, have experienced war and internal conflicts (World Bank, 2001).

Behind this new approach to development there is a changed understanding of the *process of world economic integration* and the *contribution of inward capital investment to growth.* The contribution of FDI to economic growth can be highly relevant, but its actual effects depend on a multiplicity of factors that are related to both:

(i) the *quality and scope of the inward investments;*
(ii) the *domestic conditions conducive to investment* in the host country.

Thus the effects of FDI on growth depend not only on the *capital returns* over the short term, but more fundamentally on the *direct and indirect linkages* established between the inward contribution and the local economy. A *lack of relevant linkages* leads to only a limited effect on development, mainly associated with raw material export earnings or "creation of small islands of development", bringing about "*dual effects*": with a lack of integration between a "fortunate" sector linked to foreign investment activities (mainly related to raw materials) and the isolated indigenous economy. Without substantial *spillover* effects, FDI does not induce growth and over the long term, erodes the development perspective.

The contribution of FDI to growth in developing countries is directly related to a combination of different factors related to the type and form of investment. A *small amount of low quality FDI* (in terms of limited sectoral importance, often concentrating on the primary sector, especially as seen in Africa) on the one hand, coupled with *local institutional instability*, *armed conflicts, violence and security threats*, *poor management capacity*, *non-transparent legal conditions* and *inadequately skilled local labour*, make it very difficult to create the "basic conditions" under which to develop a more favourable business environment to induce further investment and counteract the vicious cycle of cause and effect.

In the same perspective, the definition of *poverty* has profoundly changed. It is not only the *level of income per capita* that indicates the poverty of a country, but also other related *social and cultural indicators* that must complete the picture. Because development is the result of a complex set of factors, such as education, life expectancy, level of technology and skills of the labour force, as well as institutional capability, the notion of poverty has acquired a wider meaning (Tables 2 and 3).

Poverty is the consequence of a negative combination of a wide range of economic, social and institutional factors (OECD, 2001; UNDP, 2000; World Bank, 2001): this is why, in attempting to provide some measure of the level of poverty, it is necessary to include different indicators, covering the entire range of economic and social aspects. In this respect, this broader understanding of poverty takes into account the *material and intangible circumstances* that are at the same time *causes* and *effects* of such social disruption and economic degradation. This is why efforts to combat poverty have to be aimed at a broader perspective, upgrading the level of literacy, skills, human resources and institutional capacity, and an increase in the awareness of possible alternative solutions, including private sector development. The improvement of the social and cultural conditions can also, in turn, upgrade the capacity to attract FDI, since the fight against poverty is also aimed at the improvement of business conditions. The challenges in formulating an effective anti-poverty strategy are particularly difficult in the LDCs, which are also heavily indebted countries.

1.2 The problem of macro-economic imbalances and the impact of the debt burden: the HIPC initiative

Financial crises (Tables 1 and 2) and the increase in the *debt burden* of the developing countries have had a direct negative impact on FDI flows, since the financial unreliability of these nations may increase uncertainty for investors and may also contribute to political instability in those host countries that are heavily affected, in particular the LDCs. This is why resolution of the debt problem is an important concern of the affected countries, since high country debt represents a serious obstacle to FDI in that it has direct and correlated effects on investment risk.

Rapidly *increasing debt*, amplified by mounting debt service charges, in economies that have a very small economic base and often poor resource endowments has been called the *debt trap*: the repaying of the debt service charges (Table 4 in a context of no or little growth absorbs practically all of the little added-value created in such countries.

The recently instituted *Heavily Indebted Poor Countries (HIPC)* initiative has been proposed jointly by the IMF and World Bank to 33 LDCs that qualify for the initiative in order to excuse or progressively reduce their debt. In these cases, the standard and usual practice of rescheduling was no longer practicable, given the high level of financial distress reached by these countries. The approach behind the HIPC is comprehensive and co-ordinated and aims also at the improvement of the institutional capacity to manage the debt and the public policies related to the budgetary and financial matters. At the same time, there is a need to improve the *sustainability of financial rehabilitation* with other related reforms accompanying debt reduction: should such an effort not be undertaken, the reasons for the accumulation of debt in the first place would rapidly reproduce the *vicious cycle* of the "debt trap".

However, the HIPC does appear to have some shortcomings, such as an excessive enforcement of conditionality, narrow criteria for eligibility to the initiative, and a too limited amount of debt relief (UNCTAD, 2001d). Furthermore in 2001, only very few countries were able to fully adhere to the scheme, limiting *de facto* the potential beneficial impacts on financial conditions in these countries.

2. THE CONTRIBUTION OF FDI IN DEVELOPING COUNTRIES: ITS ROLE AND IMPACT

2.1. Limited quantity and poor quality of FDI: trade-offs and lack of linkages

The role of FDI could be beneficial in developing countries primarily from a macro-economic perspective, contributing to capital formation in domestic economies that suffer from a shortage of capital and savings (UNCTAD, 1999). However, the lack of substantial positive linkages can diminish substantially the macro-economic multiplier effects in the host economy and can also lead to distortions in economic development linked to FDI "specialisation" patterns.

Over the past decade, world FDI flows have increased dramatically, growing more rapidly than trade, but within this trend, the developing countries have experienced mixed results. Since the beginning of the 1980s, developing countries as a whole have benefited from a significant increase in total FDI flows, mainly green-field investments [8]: between 1991and 1997 FDI flows have even exceeded trade flows in terms of exports and imports (UNCTAD, 1999). Yet there are great disparities between FDI results in the different geographic areas, Latin America, Asia and Africa.

Africa, in particular, has experienced a dramatic and very rapid erosion of its attractiveness to foreign investors. When comparing the results over the long period between 1970 and 1997, Africa has lagged significantly behind Latin America and the Caribbean, as well as South and East Asia. While at the beginning of the 1970s, Africa attracted more FDI per US$1000 of GDP than any of the other continents – mainly because of the growing interest in the exploitation of its natural resources and raw materials – its deteriorating macro-economic conditions and the proliferation of conflict and social unrest led to a sharp decline in FDI, particularly since the 1980s.

During the 1990s, despite the rapid increase in the total volume of FDI in the world, Africa has experienced a further decline in its share of the total: total FDI flows to Africa in 2000 accounted for only 1% of world FDI inflows (in 1999 its shares of world trade were 1.6% of exports and 1.9% of imports). The very small share of Africa in global investment flows, despite representing 12.2% of the world's population (World Bank, 2000), shows its very marginal role within the globalisation process.

The most relevant features of FDI flows in developing countries in general and Africa in particular are the following:

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[8] FDI in developing countries and in particular in Africa tends to be green-field investments rather than the result of mergers and acquisitions: this pattern can be easily explained in Africa by the fact that the investments are mainly related to the exploitation of local resources and only rarely to the acquisition of African companies, given the still limited degree of industrialisation and the small size of the domestic market.

- While there has been an overall global slowdown of FDI flows to Africa, there has also been a marked trend toward a *concentration of FDI in a few countries*, reflecting the general tendency toward "concentration of production" (UNCTAD, 2001a) that is the result of the limited, but positive, improvement of the business opportunities and to a certain extent also the macro-economic performance and diversification of a few "*front runner"* countries like Ghana, Egypt, Botswana, Tunisia, Namibia, Equatorial Guinea and Mozambique. However, at the same time, this polarisation of FDI indicates that the diffusion of the gains from global integration are still very limited, accompanied by a further dramatic decrease in the weight of LDCs in the global economy, leading to their increasing marginalisation and in turn deeper recession and aggravation of the poverty spiral;
- The dominant sectoral patterns of FDI show some interesting, though limited, changes: over the past two decades, the leading role played by investments in natural resources and raw materials exploitation has declined sharply: between 1988 and 1998 the inward stock dedicated to the primary sector for all developing countries shrank by half (UNCTAD, 1999). This shift in sectoral patterns was linked to the increasing weight of manufacturing and services, particularly tourism, in FDI. While in Africa the primary sector, mining in particular, still accounts for the dominant share of FDI, there are some tentative signs of evolution toward more diversified patterns: however, the countries that demonstrate this relative improvement in diversification tend to be the same few "front-runners" as mentioned above. Many of the LDCs suffer from both poor resource endowments and weak economic potential, thus making it very difficult to improve their capacity to attract investments. Furthermore, it needs to be emphasised that the sectoral analysis of FDI corroborates the evident interest of TNCs in establishing strong sectoral specialisations in the host countries in order to benefit from the implicit externalities that these specialisations would necessarily imply (in particular in the Free Economic Zones these linkages become very explicit) in terms of related services and also a certain level of sectoral skills that the local labour resources will have acquired. In addition, it seems that when there is greater diversification in the size of foreign companies, away from TNCs, for example toward medium-sized firms, there are also relatively more diversified activities in services or tourism or low value-added manufacturing: experiences in Egypt, Tunisia, Ghana and Mauritius, for examples confirm the emergence of these positive patterns. The increasing number of medium-sized company investors - while their relative weight remains still limited in comparison with that of multinational companies - indicates a favourable trend that could bring about an encouraging increase in more friendly type of investment. At the same time, the creation of joint ventures between foreign and local companies is also improving: often the foreign companies come from other more advanced developing countries (*South-South investments*) or can be also affiliates of TNCs, in those cases where the latter pursues a strategy of developing linkages with local companies as sub-contractors.

The lack of *backward linkages* substantially limits the multiplier effects on the local economy in maximising the positive impact that FDI bring to the host country (UNCTAD, 2001a). As mentioned above, high-quality FDI and suitable local conditions are both necessary for inducing positive spin-off effects. To facilitate such spill-over effects in the local economy, the investing companies, especially TNCs, need to involve local suppliers in those cases where sectoral activities foresee a partial or substantial

share of re-investment from the proceeds of the foreign investment operation in the country in order to increase local value-added.

In this respect, the primary sector is rarely able to generate such broader linkages, while manufacturing and services certainly have broader potential for involvement of small local firms as sub-suppliers. The necessity to upgrade the *quality of such linkages,* however, is also related to the capacity of the host countries to facilitate and improve the local human resource skills and domestic economic conditions for supporting private sector development, in particular small and medium-sized companies (SMEs).

In fact, p*rivate sector development* represents the core strategic target for facilitating linkages between TNCs and small private local firms (UNCTAD - Norway Royal Ministry, 2001; World Bank, 2000b, 2001b). In the LDCs in particular, support to the creation of favourable conditions for private sector investment is becoming a priority in creating employment and increasing sources of revenue.

Among the additional factors that limit attraction of FDI and hinder the creation of positive linkages between FDI and the host country economies are the following:

(i) Limited dimension of local markets both in terms of population and its low purchasing power: thus regional integration among neighbouring countries can be beneficial in expanding market dimensions;

(ii) The chronic inadequacy of infrastructure, which suffers from serious gaps in terms of physical capacity (for example, transport, telecommunications structures) and in effectiveness of operation (power, public services, communications, etc.) that impede easy and safe physical access to markets and also ease communications with peripheral regions;

(iii) The insufficiency of the regulatory framework for foreign business operations: ineffective or non-existent regulatory measures, and legislation governing foreign assets, repatriation of capital returns, taxation and trade policy. This is aggravated by institutional inability or unwillingness to enforce them;

(iv) High transaction costs due to corruption, excessive administrative requirements and inefficiency of public administrations in particular in dealing with business.

Furthermore, the level of *capital return from inward investments* is not always sufficient to encourage such investments in the developing countries. On the contrary, the significant capital returns in Africa, in particular, seem to be linked to the TNCs focus on basic strategic targets, that are not necessarily considered a reason for attraction of further investments. In fact, the high profits generated by TNC investments in developing countries are very seldom reinvested in the host countries, but are mostly repatriated or channelled though their branch operations.

Supporting this consideration, the high *capital return* on investments of North American TNCs (Table 7), particularly in the primary sector in Africa, would suggest that this incredibly high return (twice that in the secondary sector) is the result of very intensive exploitation of basic resources, a low level of respect of safety and technical regulations in the employment of local labour, a lack of competition from domestic companies in the

local market, lax fiscal enforcement and corruption of local governments ready to comply with the requirements imposed by the TNCs: these high returns could be considered a kind of *"monetarisation"* of "*country risk*", in particular in situations where conflict or indigenous violence raise the level of danger to company operations. All of these negative factors that affect current business operations in many developing countries have become highly remunerative opportunities for those TNCs that operate in sectors that have serious environmental or health impacts on human resources, taking advantage of the poorly developed institutional framework and enforcement capacity. The issue of TNC "*social responsibility*" is now at the forefront of the international debate on globalisation and sustainable development.

2.2. FDI and the primary sector: economic distortion and environmental destruction

Mineral resources mined in developing countries are of strategic and critical importance for the economies of the developed industrialised countries. In particular, ACP oil and gas resources have become even more important in the current international political climate, representing production outside the volatile Middle Eastern/North African area. Mining and hydrocarbon exploration have been given renewed emphasis by the IMF structural adjustment programmes and WTO-promoted globalisation and trade liberalisation have pushed governments of developing countries to provide incentives for foreign investment to mining.

Among developing countries, African nations account for the most significant mineral resources output[9], especially of bauxite, cobalt, copper, gold, manganese, petroleum, phosphate and uranium, chromium and diamonds. While South Africa is a main supplier of key minerals and metals and much of the minerals processing industry is concentrated there, Nigeria and Angola are sub-Saharan Africa's major oil producers, with other important oil and gas projects in Ghana, Namibia, Mozambique and Gabon [10].

While mineral resources are of critical importance to industrialised (as well as newly industrialised and transition) countries, only limited benefits have flowed to the ACP countries in which they are extracted. In most of the host countries, resources are simply extracted and exported, without much value added. This in turn has limited the development of secondary and processing industries as well as sub-supplier chains and related higher skills and vocational specialisations. Most of the jobs for local workers in the mining/extraction related industries are low-skilled manual positions, often under hazardous conditions.

In particular, sub-Saharan Africa has been the target of mineral extraction activities without correlated industrial development. In 1999 around 60% of all private investment in Africa was in mining and mineral extraction [11], while in some countries up to 90% of

[9] In the Caribbean, Surinam and Guyana have vast bauxite resources, Trinidad and Tobago has significant oil and gas reserves and in the Pacific islands, there are rich phosphate deposits, while Papua New Guinea has extensive copper mines in Bougainville.

[10] The West African gas pipeline project to pump Nigerian gas throughout West Africa is a multinational joint-venture project that will contribute significantly to the energy security of the region.

[11] World Bank, *Global Development Finance*, 2001.

investment is in this sector (for example Zambia). Other than in South Africa, which due to its particular history has a diversified manufacturing base and a vertically and horizontally integrated economy, most countries in the region have not succeeded in harnessing the vast potential of their mineral wealth in a manner to improve welfare and foster socio-economic development. Furthermore, exploitation of renewable natural resources, such as timber and fishing, has not necessarily benefited but in many cases negatively affected host countries. Some of the problems associated with resources extraction are the following:

- *Environmental effects*: Mining has contributed to the devastation of vast areas of territory resulting in deforestation and erosion, as well as air and water pollution and even poisoning, due to the toxicity of some of the metals extracted and/or the extraction techniques. Many countries still do not have effective laws for environmental and social protection, or if they do, they are not able to (or choose not to) enforce them.

Box 1

Tainted Gold: environment and health hazards

Gold provides an example of the serious environmental and health hazards that can be caused by mining. Since 1994 more than 70 countries have changed their laws to attract foreign gold mining companies and between 1991 and 1997 gold exploration investment in Africa doubled. Mining companies use cyanide to extract gold from ore (as in cobalt-nickel mining). Cyanide is very toxic to human, animal, and plant life through contamination of ground water by the leaching solution. Mercury amalgamation in gold extraction is still used in West Africa by small-scale miners. At present, thousands of tons of mercury are being dumped in the rain forests of West Africa. Arsenic is used in artisanal goldsmithing operations, for example in Ghana, with the consequent health and environmental hazards.

- *Displacement of local people and wild animals:* as mining activities expand further into virgin territory, often disrupting traditional lifestyles and activities, irreparable damage to sensitive ecosystems and further endangerment of threatened species is often the result. There has been massive conversion of indigenous land to mining areas and land rights of tribes are being weakened in some cases (by governments intent on maximising mining revenues). In Ghana, in the mid-1990s, thousands of traditional farmers were thrown off their land to make way for World Bank-sponsored gold mining operations.

- *Vulnerability to global price volatility:* The volatility of global commodity prices can in some cases lead to the collapse of a particular industry or activity, in turn leading to negative multiplier effects in the host economies, which are highly dependent on these resources for export revenues. For example, recent declines in the gold price have had a negative impact on the Ghanaian economy (see case study on Ghana), which was compounded by the slump in cocoa prices. Other examples

were seen in the effects of the drop in the copper price on Papua New Guinea and the sharp decline of the uranium market on Niger. Such vulnerability is a critical problem of economies that are highly dependent on a limited number of globally traded commodities or crops for their export earnings.

- *Neglect of other essential economic activities*: Diversion of labour resources to gold or diamond mining from essential activities like agriculture or even production of household goods has led to a languishing of other sectors and consequent underdevelopment of the consumer market and underproduction of food.

- *Resource-linked violence:* Competition for control over mining rights for precious minerals has led to ethnic, tribal violence and even genocide in some cases. In Africa conflicts have erupted over control of diamond mining areas as well as over other strategic mineral resources, such as oil, copper, uranium, cobalt and gold, from which proceeds are often used to purchase arms and drugs and buy alliances. While the international community has made some effort at denying access to "conflict diamonds" on world markets, this has not curbed the development of the illegal diamond trade.

- *Government revenues from mineral exports do not always benefit populations:* Often revenues from extraction activities are not "reinvested" by the host country to fund economic development, infrastructure, education, health and social programmes in the regions where the resources are located. Corruption prevents benefits from flowing to the people. In Nigeria, revenues have gone into pockets of the military, while foreign investors often have little control over what happens with the taxes they pay to the government.

2.2.1. The recent decline of FDI in mining

In the late 1990s the mining industry in Africa was hurt by declines in demand as a result of the Asian economic crisis and a general drop in consumption. Beginning in 1998, exploration expenditures were being cut back, due to difficulty in raising new equity capital for exploration companies. The 1996 Bre-X gold stock scandal had led many companies, especially smaller firms, to leave Africa or to seek joint ventures with the major mining companies. Downward trends in mineral commodity prices led large mining companies to shut down mines, hurting the local host economies more than the companies and leaving the host governments scrambling to find new investors to take over these operations. While privatisation of mines has helped reverse declines for certain outputs, in general the situation of the mining sector remains difficult, complicated by the dynamics of the market linked to competition between South African and Russian suppliers. There were some improvements in commodity prices in 2000, but the global economic slowdown, especially in the largest industrialised economies, is bound to exert downward pressure on mineral commodities prices, with varying effects on different commodities and their supplier countries.

2.2.2. Determinants of FDI in mining

In the extraction industry [12], political stability, economic viability, size of the local market, level of education and skill of the workforce, etc. of the host country are often less important (though not negligible) for investors (than for example in manufacturing or tourism) – mining companies have operated in some of the most difficult environments in the world. A far more important consideration is the export market. Acceptable risk can be high if actual or perceived future returns are favourable. For example, in Colombia, one of the most dangerous countries in the world, and Nigeria, despite rampant corruption and other violence, investment remains high in hydrocarbons and minerals extraction, though future development remains constrained and mining/oil companies must shoulder the additional costs of security for their operations.

Africa has lagged behind other regions in attracting FDI in general and in non-extraction activities in particular. Nigeria made the list of top 10 FDI recipients due to its oil extraction and related activities. Another top recipient is Angola, for the same reasons. While the extraction industries continue to attract investment, the rate of new investment has been slowed by the various civil wars, tribal disputes and armed border conflicts. Furthermore, the HIV/AIDS epidemic has had a serious impact on the workforce: UN estimates suggest that in several southern African countries around 20% to 25% of the working age population is infected, reducing productivity and raising the operating costs to mining companies which absorb the social welfare and healthcare costs of employees in many countries.

Often minerals resources become the only factor of attraction for FDI, but at the same time these investments are also very sensitive to world commodity prices variation. Dropping commodity prices can have disastrous effects on the economies of developing countries (for example, Niger [13]), because of their dependence on one or two key commodities.

Abundant mineral resources and FDI in extraction activities are certainly not a guarantee of favourable development, especially if mineral rights are disputed by different armed groups. Any benefits of FDI can be eradicated easily and quickly through armed conflict. Some analysts argue that focusing on resource issues ignores the basic social, political and economic problems that fuel such conflicts.

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[12] Coakley, G., Michalski, B., and Mobbs, Ph.M., 1998, "The Mineral Industries of Africa"; U.S. Geological Survey, 1998, *Mineral Resources Program*; The World Bank, 2001, *Global Development Finance*; Jun Kwang, World Bank, 1996, W.DEC notes, *Research findings Series*, No. 16, August.

[13] Niger had been Africa's second largest producer of uranium, benefiting in the 1970s and 1980s from oil crises and the development of nuclear programmes in industrialised countries. Now, nuclear power development is on the decline and income from uranium mining has plummeted, leaving Niger's economy in a difficult situation. Yet, Niger has none of the other elements that would make the country attractive for FDI and has difficult logistical and climatic conditions that serve as obstacles to further development.

Box 2

Sierra Leone: Example of "conflict diamonds"

Prior to the early 1990s, Sierra Leone showed great promise: a large natural and mineral resource base and relative stability. Yet the country's opportunities for development faded in 1992 when fighting broke out between the government and Revolutionary United Front (RUF) forces to control the diamond-producing areas. The conflict brought about population displacements, abandonment of mining areas, and unrealised economic potential. Consequently there was a collapse in health services and a brain drain of skilled people. While Sierra Leone also has important reserves of bauxite, iron ore, chromite, gold and kimberlite in addition to diamonds, at present, mining of these minerals/metals remains underexploited. Since diamonds are mined on the surface in alluvial deposits they can be easily smuggled out with no revenues to the government, thus providing tremendous incentives for illegal activities. While there is potential for deep-mining of diamonds (facilitating control over the flow of diamonds), this requires major investment from outside, yet the interest at present is very limited due to the security situation and depressed diamond prices. The UN is trying to help to resuscitate rutile[1] production through its SYSMIN facility and also proposes prospecting for oil and gold.

[1] Titanium dioxide used in pigments.

2.3. Sustainable growth and the problem of the environment

The necessity to establish close linkages between *development and protection of the environment* is recognised by all donors and international organisations (World Bank, 2000d; OECD, 2001; UNCTAD, 2001) as an imperative requirement for ensuring the improvement of the economic and social welfare of populations while respecting environmental conditions to safeguard human health and preserve natural resources for future generations.

Sustainable development strategy translates this broad objective into concrete actions, which, in their implementation, require a *strong complementarity among the different sectoral policies*: the strong inter-dependence of each policy element linked to the poverty reduction strategy, including the improvement of the business climate and living conditions of the people, as well as efforts to combat social marginalisation, highlights the difficulties and complexities that underlie such objectives.

Because protection of the environment and combating threats to health and natural resources imply high costs, the role of public agencies and governments is essential in imposing regulations and conditions that are beneficial to the society, in term of both repairing the damages produced and preventing further damages for the future. However, if the safeguarding of the environment is to be considered a "public good", the cost that it implies has to be sustained also by private agents, including the foreign investors, when these rules are not enforced.

The fact that there is no unanimous approach to the extent to which rules have to be applied to ensure public safety, in particular in developing countries, the level of discretionary decision-making remains very high: this is indeed a very controversial issue in which different approaches give rise to evident trade-offs and also conflicts of

interest. In conditions where poor financial capacities of central and especially local governments, are combined with limited institutional capacities and a lack of enforcement of regulations, foreign investors can take advantage of this poorly developed undefined framework, with broad implications for environmental problems. In particular the TNCs are called upon to pursue policies that protect the health and the natural conditions of those regions in which their activities are located, in particular in mining, chemical and petrochemical industries, agriculture, particular dangerous industries.

The binding or non-binding nature of the rules linked to sustainable development targets depends greatly on the bargaining powers of each of the institutional, social or economic actors. This is why the issue of environmental protection and the improvement of the labour and living conditions of the people of these countries remains a very acute topic that would require an even stronger international standard regulations, to become a referent point for the individual developing countries governments, but also as regulatory framework to which the TNCs would need to comply with. Multilateral agreements need to cover these issues.

3. TRADE AND INVESTMENTS: THE EFFECT OF MULTILATERAL AND REGIONAL AGREEMENTS

3.1. Issues of the integration: the relationship between trade and investment

Within the framework of accelerated globalisation, the international organisations and aid donors in general are playing an increasingly influential role in addressing the main issues related to international financial flows and trade arrangements by encouraging the lifting of barriers to trade and investments, fostering competition in areas in which developing countries could be stimulated to improve their performances by easing access to markets. The relationship between trade liberalisation and growth is becoming increasingly evident (OECD, 2001): the improvement of the export capacity of developing countries could increase their ability to earn and reinvest in the domestic economy, favouring infrastructure development and in turn creating better conditions for attraction of FDI, thus initiating a process of economic recovery.

Due to their economies' dependence on exports, especially of primary products (minerals, timber and agricultural products) and/or simple manufactured goods (for example textiles), developing countries would benefit significantly if the present barriers to trade in the developed countries were to be lifted (UNCTAD, 1998; OECD, 1999 and 2001, World Bank, 2001). The exports of most African economies are narrowly focused on minerals and natural resources, agriculture [14] in particular, with still limited industrial or service exports. Thus, their unfavourable specialisation makes them, and especially the LDCs, extremely vulnerable to tariffs and non-tariff trade barriers that developed countries have maintained, even though these have decreased over the past decade.

In addition to their unfavourable specialisation, the LDCs are extremely vulnerable to the volatility of world market prices, which have dropped sharply over the past decade and a half, combined with declines in productivity levels, in particular for agricultural products such as sugar cane, coffee, tobacco, cotton, cocoa, and tea (CUTS-ARC, n.2-2001). This decreased level of productivity is mainly linked to low levels of agricultural technology and a lack of investment of resources in upgrading productive capacity.

Empirical findings (Hertel, T.W., et al., 2000) confirm that for particular products, such as some industrial products like textiles and clothing, but especially agriculture, trade tariff barriers are still significant, while the average tariffs for most commodities have been substantially reduced due to the effects of preferential treatment as in the case of the EU vis-à-vis ACP countries (Africa-Caribbean-Pacific) under the Lomé Agreement. The share of agricultural products exports [15] from developing countries in the imports of

[14] For instance, coffee represents 80% of Uganda total exports (CUTS-ARC, n.2, 2001).

[15] For agricultural products such as meat, sugar, cocoa and chocolate, milk, dairy products, tobacco, fruits and vegetables, the tariffs vary from 100% to 180%, but can also reach 132% to 550% for groundnuts in Japan and USA. For the food industry, the tariffs are generally in excess of 30% (World Bank, 2001b).

developed countries (Europe, North America, Japan) remains quite small, as in 2000 such trade represented only 10% of total imports (for the EU alone it was only around 3%) and less than 1/5 of actual total exports of agriculture products by the developing countries to the world. This suggests that a further reduction of the trade barriers for those products in which these countries have comparative advantages could help developing countries improve their terms of trade and further expand their export capacities. The maintenance of a high level of subsidies to agriculture, for instance in the USA and the EU[16], certainly represents a factor that hinders the capacity of developing countries to improve their export penetration potential and limits their economic gains (World Bank, 2001b; OECD, 2001b; UNDP, 2000).

However, trade flows are not only limited by direct tariff barriers, but also non-tariff barriers, such as quotas, ceilings or seasonal restrictions and quality standards. Quality-linked restrictions include sanitary and phyto-sanitary (SPS) measures and technical certifications: these latter criteria reflect the high level of quality standards and safety regulations for food, agricultural resources and consumer goods that are imposed on third country exports in the developed countries, and in particular the EU. An important issue is understanding how such technical and safety standards that need to be respected by developing country exports can be improved in order not to reduce or circumvent the current high level of health, safety and consumer protection in the developed countries, which were a result of strong civil society initiatives. The very low level of control over the quality and technical attributes of food and consumer goods in the developing countries in general is the result of social, economic and institutional shortcomings, such as:

(i) the absence of active consumer protection and awareness of these issues, including a lack of civil society initiatives;
(ii) the lack of technical and human resources capacities of the institutions that need to deal with these matters;
(iii) the low level of sanitary and health care systems in general.

At the same time, these developing countries maintain even higher trade barriers, de facto limiting South-South trade flows: the regional agreements, as discussed below, are in fact also aimed at the liberalisation of their respective trade regimes in order to lift the barriers that limit penetration of markets, however with still very mixed results and in many cases with complete failure. The maintenance of high tariff barriers by the developing countries clearly reflects the defensive behaviour of weak economies that fear the effects of competition. However, limited South-South trade is also the result of other structural features, such as the unfavourable product specialisation among them, producing competing or similar exports (mainly agriculture or raw materials).

The GATT negotiations under the Uruguay Round have led to a significant improvement in the regulations against unfair practices. In previous decades, GATT

[16] The EU initiative *"Everything but Arms"* is focused on permitting free access for all type of LDC exports, excluding armaments. This initiative will be introduced through the modification of the *Generalised System of Preference* (GSP). However, for sugar and rice, the full liberalisation will be postponed until 2009, due to the sensitivity of the internal European market to imports of these two products.

policies had left far too much discretion to national governments in the adoption of trade and competition rules. The necessity to reach a trade agreement with a higher level of transparency and unambiguity and in particular a capacity for its effective enforcement was a founding principle in the establishment of the World Trade Organisation (WTO) in 1995. The new WTO also called for a stronger policy implementation commitment of all members. In particular, the rules that have to be enforced by new members are significantly more rigorous than they were several decades ago. These tighter constraints will also have a greater direct impact on the domestic reform agendas of the new members of the WTO, as China confirms (OECD, 2002a). This suggests that speeding up the processes aimed at improvement of competition and economic restructuring (including privatisation) in order to strengthen the performance of the private sector, will also in turn provide a powerful incentive for further FDI attraction.

However, investment matters received far less attention within the negotiations – as the previous GATT did not provide specific tools to address these fields – and these issues are now emerging within WTO discussions as the key factor that will need to be regulated more effectively. The relationship between trade and investment regimes is, in fact, strongly positively correlated: in many cases the major recipients of FDI are also the countries most open to trade flows (OECD, 2001). Furthermore, trade liberalisation can lead to a progressive improvement of the local market, providing new opportunities for accessing financing for the domestic economy.

In May 1995, the OECD made an attempt to elaborate a comprehensive multilateral framework for international investment with the proposed Multilateral Agreement on Investment" (MAI). The MAI was conceived as a "free-standing" [17] instrument providing new bases for pursuing further liberalisation of investment regimes, offering investment protection to investors with effective dispute settlement procedures. However, the bases on which the Agreement was proposed were not comprehensive enough in terms of investor obligations toward the host countries. A large number of European countries and several developing countries [18] disagreed on issues regarding rights to entry and establishment, criticising the too permissive and one-sided rules. The major beneficiaries of this initial proposed framework would have been the TNCs, which, taking into consideration the lax "code of conduct for TNCs" of non-binding nature, would have gained higher guarantees without clear obligations vis-à-vis the host countries. Eventually, the MAI was abandoned in 1998 due to the impossibility of reaching a coherent agreement on this large set of issues.

The failure of these attempts to directly address at an international level the standard rules for investment protection and investor and host country obligations has increased the pressure on the WTO to make progress in the elaboration of more adapted instruments that address investment and competition matters and promote closer linkages between external policy regulations, involving trade and foreign investment, and domestic policies. In this respect, the July 2001 the WTO Doha Conference represents a step forward, both in providing for more coherent implementation of the

[17] Open to all OECD members and non-members.
[18] In February 2002, the OECD has disclosed the MAI documentation and reports - however omitting mention of the different country opinions, related to OECD Ministerial committees held during the negotiation period that ended in 1998.

Uruguay Round provisions and in highlighting the importance of other provisions linked to investment, such as the Trade-Related Aspects of Property Rights (TRIPs), Plurilateral Agreement on Government procurement (treatment of foreign enterprises and protection of certain property rights), the Agreement on Trade-related Investment Measures (TRIMs) and the Agreement on Subsidies and Countervailing Measures (ASCM): all of these agreements directly and indirectly address certain fields of operation and attraction of foreign investment, in particular those related to trade liberalisation.

3.2. Multilateral and regional agreements and compliance with international competition rules

Within an increasingly globalised world, multilateral agreements, such as those pursued by the WTO for trade, play a fundamental role in clearing away the obstacles and protectionism that still hinder the process of integration of the developing countries into the world market. Multinational agreements, despite the difficulties that still remain in their effective implementation, are essential and primarily more beneficial to developing countries, because they represent a powerful instrument for imposing rules and disciplines, which developing countries would not be able to enforce due to their weak bargaining position.

At the same time, an increasing proliferation of regional agreements appears to offset the trend toward greater standardisation of liberalisation rules, instead creating a regionalised network among neighbouring countries. Regional trade and investment arrangements are the result of an emerging trend in which globalisation and regionalisation are becoming more complementary for certain elements, yet can also lead to sharp differences in other cases.

3.2.1. The Cotonou Agreement and its innovative approach to poverty reduction and market integration: the search for linkages

The Cotonou Agreement between the EU and the ACP (Africa-Caribbean-Pacific) [19] countries represents one of the most coherent and innovative approaches to poverty reduction, sustaining the progressive integration of developing countries into the world economy. The Cotonou Agreement is not solely a trade agreement but has a comprehensive nature, covering the different components that are essential for the progressive improvement in the ACP countries' ability to deal with the problems of development and integration, effectively replacing the previous Lomé Conventions that were negotiated under conditions that have profoundly changed over the past few decades. The enhancement of trade relations therefore needs to be more coherently linked to developments in other policy fields that the developing countries need to address in facing the tremendous challenges of globalisation and increasing competition.

[19] Of the 78 countries comprising the ACP, 40 countries are Least Developed Countries (LDCs), including most of the 49 LDCs in the world.

The main features of this innovative approach are the following:

(i) A principal role is played by political willingness and good governance as fundamental conditions for limiting policy failure: EU aid will become conditional on good governance. The linkage between political compliance and policy effectiveness, which in turn are related to institutional capacities, is a core issue in the coherent pursuit of a development strategy that favours integration into the world economy;

(ii) The promotion of peace, transparency, and democracy and combating corruption are related targets that represent basic principles also in improving the political environment and the relations between the EU and the ACP;

(iii) Increasing the role of civil society in ACP members is the second sensitive issue that will be encouraged: the emerging social actors, organised in different forms as NGOs, non-state actors including local authorities, and emerging private sector representatives, need to become active players addressing economic and social issues in their countries. The mobilisation of civil society is a fundamental prerequisite for creating those endogenous capacities to sustain development: not only improvement of central government institutional capacity is necessary, but also mobilisation of local actors from the bottom up in order to progressively overcome inherited passive behaviours linked to an assistance-dependent culture that makes it more difficult to encourage local actors to undertake initiatives to improve standards of living and generate employment. The establishment of a good public-private partnership could also improve information access and dialogue on specific needs and local initiatives, that are to be addressed by the Country Support Strategy;

(iv) Trade co-operation has changed profoundly since the last Lomé Convention, moving towards abandoning the previous practice of "non-reciprocal trade preferences"[20]. The results of the earlier Lomé Agreement have been disappointing in terms of market penetration by the ACP countries: the share of ACP exports to Europe remains insignificant and has even decreased by more than half over the 25-year period, 1975-2000 (from 8% to only 3% of total EU imports). It is evident that the reason for the decline is not purely trade barriers, but structural impediments. Under Cotonou, the Lomé agreement will be replaced by different trade and economic co-operation agreements, that starting from 2002 will be called "Economic Partnerships Agreements" (EPA) and will go into force by 2008[21]. For the LDCs, the old formula of "non-reciprocal treatment" would be maintained. whereas it would be eliminated for the other countries that need to open their markets progressively and also reciprocally: this gradual opening of the markets would also facilitate a process of learning to deal with competition and overcome the artificial protectionist compromise of non-reciprocity. For those non-LDC countries that would still need more time to

[20] This formula allowed the ACP countries not to be obliged to open their domestic markets to the European export, whilst the European import from these countries would have very low barriers.
[21] However, this option will not be compulsory for all countries; rather there will be an adapted approach linked to the level of economic and institutional readiness of each country or regional grouping.

adjust to international competition, there could be still the old Lomé option. The instrument for sustaining and promoting EU-ACP trade will be the newly established European Development Fund (EDF). Implementation of these various types of trade arrangements would, however, require the approval of the WTO, which seeks to accelerate abandonment of discriminatory instruments of “preferential regimes”;

(v) The EU strongly encourages the ACP countries to establish Regional Agreements. These agreements are viewed as facilitating the process of integration of the individual countries into the world market and also could simplify the establishment of the Economic Partnership Agreement with the EU following the abandonment of the previous Lomé Convention, since the EPA could be signed by grouping and not only by individual country. However, numerous constraints still hinder such a development: the Regional Agreements are generally still incomplete and often have a low level of integration (“free trade” or “customs union” or “single market”) and their institutions tend to be inadequately prepared for and lack the capacity to sustain lengthy negotiations followed by the consequent enforcement of the negotiated principles. These inadequacies, despite pressure from the WTO, make it much more difficult to achieve progress in the process of reorientation of the trade arrangements which seek to apply less discriminatory rules and practices among the beneficiary countries;

(vi) A complete shift in aid allocation practices: the provision of development assistance aimed at poverty reduction will not be allocated automatically on a fixed basis. The delivery of the aid will be conditionally be linked to the country's performance, so that if resources have been effectively utilised, further aid disbursement would be confirmed, while in the case of failure or mismanagement, the aid would be reduced. This linkage between the delivery of EU aid and the recipient country capacity to ensure aid effectiveness is aimed at ensuring better utilisation of EU funds, to avoid their dispersion, while improving their positive impact; at the sane time it could also push the recipient country toward to seek better exploitation of scarce resources, implying a certain “learning process” that imposes financial discipline.

Thus, the Cotonou Agreement is focused on the improvement of the overall conditions for sustainable development: it is clear that all efforts aimed at enhancement of the political and institutional stability together with more effective domestic policy would improve the overall conditions and capacities for attracting foreign investments.

3.2.2. The regional agreements: highly differentiated levels of integration

While regional cooperation agreements are not necessarily a recent phenomenon in ACP countries, as the post-colonial period during the 1960s and 1970s saw the creation of various arrangements, since the early 1990s, there has been a proliferation of Regional Arrangements: by 1995, some 260 regional arrangements had been notified to the WTO. The increasing interest in regional integration was reawakened due to a number of reasons:

- As demonstrated in several successful cases in different regions of the world, regional agreements have proven to be a strong catalyst for the improvement of the competitiveness based on the progressive lowering of trade and investment barriers vis-à-vis neighbouring countries - thus helping to facilitate industrialisation and regional market integration - contributing to slowing down the transaction costs for capital movements in the region. Outside Africa, the East Asian example (ASEAN) is certainly the most relevant for comparison in terms of the successful development strategy realised;

- The principle of "proximity" of markets is not based purely on geographic criteria, but also has broad cultural and historical implications, thus making the process of integration much easier than an individual country might achieve in the world market, improving also the investment climate;

- Given the small size of the domestic markets of most developing countries, in particular African nations, regional agreements facilitate the creation of much larger market outlets, with possible improvement in the allocation of resources: the capacity to attract FDI would also improve, because the emergence of a regional market could reinforce a more advantageous allocation of labour resources and specialisation within the regional area. The TNCs have, in fact, encouraged these trends, since they will be better able to exploit the comparative advantages of closer regional integration in their global de-localisation and specialisation strategies. There are several cases where the TNCs have favoured the creation of regional country network, promoting deeper specialisation of their affiliates or sub-contractor companies (that might also be joint ventures), located in the different countries of the region: one good example is Toyota's strategy in the East Asian region;

- The process of regional integration also could facilitate technology and financial transfer between the neighbouring countries, combined with greater ease of diffusion of information on market opportunities, technology and innovation;

- Furthermore, regional agreements could facilitate the development of required infrastructure and transport linkages, especially those with a cross-border relevance, improving the mobility of factors and goods.

The Cotonou Agreement between the EU and the ACP countries sees regional agreements as a valuable instrument in promoting integration among neighbouring and nearby countries in different geographic areas, as mentioned above. Also the WTO Doha Conference addressed the issue of coexistence of regional and multilateral agreements, especially in matters regarding investment: it has been emphasised that many regional agreements go beyond the WTO rules, thus there could be room for positive integration, but also raises the possibility of sharp inconsistency, especially with regard to the "rules of origin" (which imply protection measures) and "labour mobility" (where there can be highly differentiated approaches).

In fact, the extent of trade, monetary and economic integration within the regional agreements (whether as a free trade area, customs union, single market, currency union, or other type of arrangement), varies significantly, depending also on the historical and

cultural background, especially the colonial heritage. Integration is the leading principle behind most of these arrangements, but is not always coherently pursued.

Among the African countries, probably the most successful and relevant regional agreements are the following, though their levels of integration vary and some of them have uncertain futures: ECOWAS (West Africa), UEMOA (the former French Franc zone in West Africa, that has also achieved monetary union), CEMAC (the French Central African countries), COMESA (Eastern and Southern African States), and SACU (Southern African Customs Union).

Box 3

The most relevant Regional Agreements in the ACP countries

Regionalism among ACP countries experienced strong growth in the 1960s and 1970s, yet the roots of regional economic integration efforts in some parts of Africa date back to the early 20th century (i.e., the establishment of the *Southern African Customs Union* in 1910). Various attempts at economic co-operation and integration have collapsed due to a series of problems, as seen with the *East African Community (EAC)*--which was perhaps the most developed of integration experiments [2]. While strong interest in co-operation as a principle certainly exists, in practice it has been difficult to apply. Many of the countries (including in the Pacific and Caribbean) maintain closer links with their former colonial powers than among themselves. Within Africa, several of the agreements are organised on a linguistic and colonial heritage basis, for example **WAEMU (UEMOA)** in West Africa which (except for Mauritania) and **CEMAC** in Central Africa belong to the *French Franc Zone* and use the *CFA Franc*, which was pegged to the French franc and now the Euro since 1999.

Since the 1990s, and especially since the dismantling of Apartheid, there have been renewed attempts at further promoting regional integration in Africa. Among ACP countries, Sub-Saharan Africa now accounts for the largest number of such groupings, many of which are overlapping and have similar objectives; however, for the most part integration of economic activities and lowering barriers to trade while facilitating commerce, currency exchange and protection of investments and intellectual property have been limited. Yet there is optimism that some of these arrangements will work, despite substantial obstacles. In terms of implications for FDI, trade liberalisation will assist exports of manufactured or extracted products and uniform, transparent and harmonised investment, tax and tariff codes will improve conditions for investors.

Some success has been achieved in Southern Africa and in the Franc Zone countries in West Africa and Central Africa. Within the **Franc Zone** a number of strong initiatives [3] have been undertaken, for example the harmonisation of customs and tax systems with the introduction of VAT and implementation of customs unions in January 2000. Furthermore, a monitoring system was set up to monitor compliance with priorities set for members; however CEMAC members have a later compliance date (2004) than WAEMU members (2002).

Below is a brief overview of the main regional economic integration initiatives in Africa

- **Economic Community of West African States (ECOWAS)**[4]. While ECOWAS has been in existence for several decades, it has been far more active in institutionalising its activities in recent years. ECOWAS seeks monetary union of non-CFA Franc countries by 2003, followed by monetary union of all ECOWAS countries in 2004. Monetary union has been a long-term objective since the origins of ECOWAS in 1975, reinforcing the broader integration process favouring regional trade and establishment of common institutions. In the past, national priorities and problems inhibited greater integration among members, accentuated by sharp differences in levels of economic development and trade patterns as well as the different path of development taken by the Franc zone WAEMU (UEMOA) members of ECOWAS in comparison with non-CFA ECOWAS members. A number of regional studies suggested a number of concrete actions, which –– if undertaken –– could have significant implications for investment in the region: promotion of industrial integration, food industries and building construction materials as well as chemical and petrochemical industries. Such actions could particularly favour foreign investments by smaller and medium-sized companies, especially in terms of joint ventures with local firms.

- **West African Economic and Monetary Union (WAEMU**or **UEMOA** in French) was formed Jan 1994 of Francophone West African countries[5], which are also ECOWAS members. In recent years WAEMU has made substantial progress toward greater regional integration as noted above. Though it has been found that while the CFA franc has offered some monetary stability (low inflation), growth performance has not really been better than elsewhere in Sub-Saharan Africa and intra-regional trade (and investment) remains relatively low[6]. However, this is likely to change. An important step in this direction has been the application of the *Convergence, Stability, Growth and Solidarity Agreement* (Dec. 1999) proposing concrete steps and priorities toward integration that member countries must apply and implementation of a monitoring system.

- **Communauté Économique et Monétaire d'Afrique Centrale (CEMAC) (Central African Economic and Monetary Community)**In the early 1990s the Union Douanière et Économique de l'Afrique Centrale (UDEAC) (which was renamed CEMAC in 1994) has sought to replace the extremely complex and confusing system of tariffs and taxes previously applied with a simplified and transparent system and the institution of a generalised system of preferences intra-UDEAC. For example, in the mid-to-late 1990s CEMAC member Cameroon has undertaken a significant reform of its trade protection of industry. Yet not all countries in the Central African group have followed suit, limiting the effects of further economic and trade integration.. As mentioned above, CEMAC is also part of the CFA Franc zone in Central Africa and has entered a customs union with WAEMU countries in 2000, enjoying harmonised customs and tax systems.

- **Common Market for Eastern and Southern Africa (COMESA),**which replaced the former *Preferential Trade Area (PTA)* in December 1994, has the objective of creating a free-trade zone that is to evolve into a customs union by 2004 and a common market thereafter. The strategy is to attain "economic prosperity through regional integration" by overcoming barriers that are faced by individual members. Like ECOWAS, the group is characterised by significant differences in the development level, resources, size and trade and objectives of the members (also see case study on Mauritius). With 20 member states[7] and 385 people, it represents a huge consumer market, though with limited spending resources. By creating a favourable business environment and legal framework COMESA seeks to encourage the growth of the private sector, establish a secure investment environment and adopt a common set of standards[8]. Furthermore, several institutions to promote sub-regional cooperation and development have been established. COMESA has

had some success as a result of trade liberalisation, though only a few of the countries are benefiting, since they had extensive export-development programmes (including Mauritius, see case study). The potential for trade is limited by export dependence on primary and semi-processed materials with limited value added, with not much demand for these products in the regional groupings, except in the more advanced economies such as South Africa and Mauritius, though Mauritius represents a minuscule market. Preferential treatment of goods produced by domestically owned and controlled companies can be counterproductive to investment [9].

- **Southern African Customs Union (SACU)**[10]. The oldest and by some standards most effective (or most integrated) of the groupings, **SACU** achievements have been driven mainly by the Republic of South Africa, which remains the most advanced economy and major investor in the area. SACU has been able to remove trade barriers, establish a common external tariff and stimulate economic relations and flow of production factors between members. However, the future of the arrangement, including the revenue-sharing provisions benefiting the other members, has made continuation of the current practices less attractive to South Africa. The area is characterised by skewed trade patterns, for example of the countries bordering on South Africa (especially Zimbabwe). A Sub-area is the **Common Monetary Area (CMA)** which emerged in 1986 from the 1974 Rand Monetary Agreement between South Africa, Lesotho and Swaziland. Namibia has also joined the CMA in 1992. Furthermore, there are numerous **bilateral trade agreements with South Africa**, mainly localised in Southern Africa.

- **Southern African Development Cooperation (SADC)**[11]**.** While SADC was originally established as the *Southern African Development Coordinating Conference* (*SADCC)* in 1980 to reduce dependence on Apartheid South Africa in the region and to present a unified front in accessing development financing, since the collapse of Apartheid, South Africa has been a strong force within the group. There is an overlap of members and initiatives with SACU, yet the sheer size of the group and the sharp diversity of members was made it more difficult to apply uniform approaches.

- **Cross Border Initiative (CBI)**[12]. The 14-member CBI is important since it is sponsored by the major multilateral organisations, including the IMF, the World Bank and the EU, thus indicating a strong extra-regional interest in the success of the effort. The CBI is not a trading bloc or institution, but a framework of harmonised policies to facilitate a market-driven concept of integration in Eastern and Southern Africa. CBI differs from other approaches in its flexibility, emphasis on the private sector as the driver of growth and development, voluntary adherence versus treaty obligation, and integration in the global economy rather than erection of trade barriers to extra-regional markets, the Initiative is focused mainly on harmonising and effectively reducing external tariffs and intra-group trade liberalisation and deregulation of investment. CBI has many of the same members as COMESA, SADC and SACU. The *CBI Road Map for Trade Reform* comprises several immediate actions in selected priority areas to promote investment, including a regional level public relations campaign, the establishment of a CBI website, and examination of the feasibility of establishing cross-border investment fund. Furthermore, the participating countries need to take concrete action to improve business conditions, especially in providing information on opportunities, better services and infrastructure, eliminating bureaucratic hassles as well as ensuring security.

Some of the less-evolved regional cooperation initiatives in Africa include the **Economic Community of the Great Lakes Countries (CEPGL), the Manu River Union (RU)**, and **East African Community/Cooperation (EAC)**, which are far more limited in scope and scale.

Important regional groupings in ACP countries outside Africa include the **Caribbean Community and Common Market CARICOM**(est. 1973), aimed at economic cooperation and integration through lowering of trade barriers in the Caribbean, and the **South Pacific Forum (FORUM),** mainly a forum for political discussion, which administers the South Pacific Regional Trade and Economic Co-operation Agreement (SPARTECA) providing non-reciprocal duty-free and preferential access for FORUM members to Australia and New Zealand. The above agreements have had limited success due to gaps in infrastructure and linkages, the physical and economic isolation of the players (particularly in the Pacific) and the smallness of the economies and limited resources. Certain Caribbean countries have become offshore tax havens for investors, leading to significant growth of the tertiary sector and related employment in these small island economies. Yet high dependence on inflows linked to volatile global financial markets as well as tourism remains a fundamental weakness of such economies. The **Association of Caribbean States (ACS)** including ACP CARICOM members, Colombia, Mexico and Venezuela, however this has been more of a political forum with limited perspectives due to the sharp divergences in the countries profiles.

[2] The EAC comprised a customs union, a single currency, a Development Bank and undertook a variety of regional infrastructural services, such as transport.
[3] A number of other bodies were set up within the *Franc zone* to promote harmonisation of policies in legal issues (OHADA - Organisation for Harmonising Business Law in Africa), insurance (CIMA - the InterAfrican Conference on Insurance Markets), social affairs (CIPRES -the InterAfrican Conference on Social Security) and statistics (AFRISTAT- the Sub-Saharan Africa Economic and Statistical Observatory).
[4] Members include Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal, Togo, Cape Verde, the Gambia, Ghana, Guinea, Liberia, Nigeria and Sierra Leone.
[5] Benin, Burkina Faso, Côte d'Ivoire, Guinea Bissau, Mali, Niger, Senegal, and Togo.
[6] Masson and Patillo, IMF, 2001.
[7] Angola, Burundi, Comoros, D.R. Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia and Zimbabwe .
[8] COMESA web-site.
[9] ECA, 1997.
[10] Botswana, Lesotho, Namibia, South Africa and Swaziland.
[11] Members now include Angola, Botswana, Democratic Republic of Congo, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, United Republic of Tanzania, Zambia and Zimbabwe.
[12] Burundi, Comoros, Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles, Swaziland, Tanzania, Uganda, Zambia, and Zimbabwe.

There are a number of important issues regarding the shortcomings of the regional agreements:

- The participation of individual countries in different regional groupings (sometime they are members in two or three and even more different arrangements) can create *overlaps and problems in harmonisation* of discordant levels of trade liberalisation, sometimes leading to *trade diversion effects* (WTO, 2001). "*A la carte*" integration (OECD, 2002) could lead to incompatibility with general WTO rules, in particular concerning the benefits associated with " *preferential treatment*", resulting in broad disparities in individual case treatment and significant distortions in trade among the countries involved;

- The *level of complexity of individual regional agreements* (WTO, 2000 and 2001) represents a further administrative burden and higher transaction costs for the still generally weak institutional management capacities of these countries in contrast with the more concentrated and simplified efforts within the multilateral negotiations under the WTO or other relevant agreements, such as Cotonou;
- Despite great expectations for the regional agreements, it has become evident that the increase in *intra-regional trade* within the grouping, especially in Africa, has not been always as significant as initially foreseen and in some cases has even decreased since 1990 (World Bank, 2000). The same trend has occurred for investments, especially in light of the limited financial capacities for South-South foreign investment, while investors from some of the more successful countries have also started to invest in the region. Besides the high trade barriers that are still in force in many cases, the main obstacle to full exploitation of the favourable conditions presented by market proximity is the still *limited potential for complementarities*, because of *unfavourable economic specialisation*, mainly concentrated on raw materials and agriculture (OECD, 2002). The specialisation in a dominant monoculture or a few commodities tends to favour competition rather than co-operation among neighbouring countries. Only those countries with relatively more diversified economies are the most interested in increasing regional trade, since they are better able to benefit from increased export revenues, which more than make up for fiscal revenues foregone due to the lowering of tariffs;
- The still *limited development of intra-regional communications, transport and physical infrastructure* in general: the investments required to establish and improve these capacities are very substantial and there are serious gaps in the financial resources available for such major projects in the regions.

These very substantial obstacles to the process of regional integration are linked to the structural gaps and rigidities that are in turn related to the lack of progress in domestic reforms and weak institutional capacities. For most developing countries it has been difficult to engage in an external integration process, while at the same time maintaining defensive behaviours and backward conditions in their domestic economy. This indicates that to a certain extent, the *South-South integration process* will continue to encounter barriers to its further advancement: the relative success of some of the integration processes reveal that where there are more advanced and diversified economies, the conditions are far more conducive to eliminating barriers to investment and trade. However, some opinions (Yeats, A, 1998) emphasise that for the developing countries *North-South* integration could provide far more benefits than *South-South* regional integration: the transfer of knowledge, investments and goods could prove to be more advantageous in term of the implicit benefits they could bring (i.e. knowledge, technology transfer, trade and investment practices, higher standard services etc.) to developing countries, rather than trade flows involving low value added products and little added knowledge or technology. However, the present difficulties should not cloud the fact that regional agreements, if more coherently pursued, can represent a powerful means for the consolidation of a more culturally and socially acceptable market orientation.

3.2.3. The Bilateral Agreements: contributing to a liberalisation of investment rules

In the absence de facto of any major agreement at the multilateral level covering investment treaties, countries have depended largely on bilateral negotiations to promote and protect FDI. The last decade has seen a growing number of Bilateral Investment Treaties (BITs), with an increasing number of them involving developing countries [22].

Despite growing convergence in the type of provisions that they take into consideration, not all these agreements are the same in their treatment of FDI issues. On the contrary, there are significant differences that can be observed mainly with regard to their coverage, the degree of discipline they introduce and the extent to which they contribute to the regulation of FDI. The BITs contribute, in principle, to the establishment of a favourable investment climate between two countries, ensuring "protection and security" together with certain standards of treatment and independent third-party settlement of disputes.

However, practice shows that the enforcement of the provisions in the host countries, even in presence of formal agreements with individual countries or regional groupings, as in regional agreements, depends heavily on the legal framework and the levels of transparency and policy enforcement that exist in the host environment: in consideration of the high level of risk and unstable legal and political environment in developing countries, the BIT can also be incapable of ensuring full protection and security required by foreign investors. This is why multilateral agreements could become a more powerful legal instrument with a greater capacity to be enforced, providing an appropriate compromise between the defence of the rights and obligations of both the investors and the host countries.

In this regard there is an increasing need to achieve more coherence and greater *complementarity and harmonisation* between the three levels of agreement, bilateral, regional and multilateral, since if each of them address similar issues differently, they can also cause overlaps and inconsistencies for the same provisions, having the effect of "*treaty congestion*" (OECD, 2002): again here is evidence that indicates a strong need for the establishment of multilateral investment liberalisation rules.

3.2.4. The enforcement of regulatory bases for TNCs and their "social responsibility"

The central role played by the transnational corporations (TNCs) in the process of globalisation has raised the complex issue of the " *social responsibility*" that these firms bear when they operate in developing countries. The *social responsibility of corporations* is a subject that has been treated since the 1970s in the *international codes of conduct*. However, it has been always a controversial issue that did not enjoy unanimous consensus of the different economic and institutional players in both the country of origin of the TNC and the host countries, in particular the developing countries. This is why, up to the present, the most recent elaboration of Guidelines for

[22] In January 1997, there were 1 330 BITs in existence, while according to the UNCTAD World Investment Report - by 2000, the number of BITs had risen to 1 856.

TNCs by the OECD has only had a *voluntary* character and not a binding nature (OECD, 2001a, 2001b).

The OECD elaboration underlines the importance of the efforts that need to be made to improve the relationship between "business" (i.e. the TNCs) and the (host) society: *corporate responsibility* implies the interest of the TNCs in improving the social and economic conditions in the host countries where they operate: in the best cases, the interests of the large corporations would coincide with the interests of the society, also providing positive results for the TNCs, in improving the general conditions in the markets where they operate over the short-tern as well as long term perspective. An *ethical* approach, if in some cases seeming to corroborate the global strategy of the TNCs, can bring about an upgrading of local production factors (for example, human resources), creating employment and favouring some technology transfer, while at the same time respecting the environment; however, such an approach remains confined to isolated cases that cannot be generalised.

Experience has shown (OECD, 2001a) that there is wide range of TNC behaviour, making it difficult to impose ethical investment regulations – which are generally more or less enforced in the advanced countries – on such corporations, given the weak institutional capacities existing in developing countries. The main weaknesses that characterise the latter can be summarised as follows:

- *Legal and institutional weaknesses* imply an incapacity to exercise significant pressure on the actions and management practices of the TNCs. The absence of a sound and effective legal framework, leaving the functioning of the market highly unregulated and non-transparent, makes easier for TNCs to take advantage of lax legal conditions;
- *Uncertain institutional capacity in implementing public policies* by host country governments remains a critical factor that contributes to policy failure in the enforcement of specific regulations, especially in those fields that rely on international inputs: there is often a serious gap between the national policy-making and institutional capacity and the global nature of these regulations;
- *Weak political commitment and widespread corruption* that plague many of the host countries' governments erode the capacity to counteract any abuses that the TNCs might undertake;
- The *absence of or still very weak public debate involving civil society in the host countries* on the relevance of such rules. The deficiencies in the existence of "*informal norms*" as part of the *social capital* of these societies (i.e. developing countries) make it more difficult to develop conditions for more regulated functioning of markets. In absence of these *intangible assets* that could reinforce the implementation of regulations, the respect of such rules would be necessarily only of compulsory nature and completely dependent on sanctions, which in turn would require very effective and efficient administrative, legal and security structures that are often lacking in these countries.

Consequently, this new concept of "*social responsibility*" is emerging as a fundamental issue in international debate, yet it also implies a number of complexities. To date, most

International Agreements have failed in effectively addressing this issue: there is an urgent need to reach a compromise that helps protect the host countries from abuses, while at the same time respecting TNC business requirements. Only a few regional agreements have started to take some of these rules into consideration, primary among which is the *Cotonou Agreement* between the EU and the ACP countries. This agreement can be considered the most comprehensive in that it comprises a broad set of rules of "social responsibility", some of which also have a binding nature, for example in environmental protection, labour rights and some social policy objectives.

The main critical issues that are included in the " *social responsibility"* chapter are the following:

(i) *Environmental issues*: these are among the most sensitive for the developing countries, because of the dominant sectoral specialisation, either in mining, logging, plantation agriculture, and petrochemicals, which have a direct impact on the environment. The TNCs are called upon to contribute to sustainable development by avoiding uncontrolled exploitation of resources, even in the absence of effective monitoring by the host country institutions;

(ii) *Labour safety problems:* with the predominance of investment in the primary sectors, especially mining, there is a strong need to elaborate strict *labour safety rules and health standards* that need to be applied in local business operations. The absence of active trade-unions or labour organisations among the workers should not to become an opportunity for investors to relax the respect of basic principles regarding labour safety conditions;

(iii) *Human rights and basic labour standards and conditions* (ILO, 1998) need to be respected by the TNCs, taking into consideration the cultural and social background of local communities from which the labour resources come;

(iv) *Information disclosure*: the often monopolistic position of the TNCs in host country markets leads to the emergence of *de facto* barriers to information and access to knowledge about all aspects of the TNC's operations and products. The TNC should provide information about their activities, structure, financial performance, and risk factors that might be linked to the products or processes employed. Thus, information disclosure needs to cover all fields where risks might be involved such as risks to persons and the environment;

(v) *Anti-corruption*: Poverty, institutional weaknesses and the lack of an institutional framework conducive to business have created an environment in which corruption is endemic. TNCs are called upon to fight corruption and not to comply with the demands of crooked officials;

(vi) *Consumer protection*: despite the low level of civil society debate and awareness of food safety and consumer protection in host countries, TNCs need to address the problem on their own, respecting standard rules recognised as necessary by experts and consumer advocates in home countries, also following the advice of international organisations such as the OECD and UN.

It is evident that these rules touch on a wide range of different fields of actions and imply complex linkages among policies (UNCTAD, 2001). Among the most critical policy fields addressed are the following:

(i) *Competition*: competition policy is the primarily field in which the regulations for the TNCs need to be effective, limiting the possible abuse of their dominant position (control of markets and prices) vis-à-vis domestic companies by creating *de facto* internal barriers that hinder competition and limit access to the domestic market;

(ii) *Taxation*: This is a relevant financial issue for the host country authorities so that they can compel TNCs to pay fiscal obligations where they operate and prevent their avoidance of taxation through the unfair practice of "transfer- pricing";

(iii) *Transfer pricing*: This is a practice that is very diffused among TNCs, which effect direct transfers between their own affiliates located throughout the world, without declaring revenues in the host countries: through transfer pricing, most if not all profits are sent to other locations (country of mother firm or other affiliates), having the dual effect of circumventing fiscal duties and limiting substantially further investment, *de facto* diverting potential spin-off effects away from the host countries and seriously limiting the macro-economic and microeconomic benefits of such investment;

(iv) *Technology and knowledge transfer*: the TNCs could induce positive effects in upgrading the technology, skill and knowledge levels of local labour resources and easing access to "*socially useful technology*"[23] (Unctad, 2001), taking into consideration the educational and social background of the host country. There are various new trends in technology transfer that have been facilitated by telecommunications technology and applications (e-commerce in particular) that could open new avenues to technology transfer and access to information;

(v) *Development obligations* are the most controversial issue because of the wide-reaching implications: While the other practices can be well-defined because of relevant legal and economic legislation associated with them, " *development obligations*" depend on a very strategic approach of the TNCs in terms of their obligations and responsibilities toward the society and economy in which they invest. Such an approach requires the acceptance of corporate responsibility with a broader goal, contributing to improving the conditions for the development of local business and, as result, to improve the well-being of the local population. This view requires a strong social commitment by the TNCs. While isolated cases of a socially responsible approach might emerge, it would be misleading to expect a generalised spontaneous engagement. In this regard, there is a significant gap in the capacity to enforce international legislation that needs to be addressed.

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[23] The notion of *"socially useful technology"* refers to technology that responds to the needs of the host countries, considering the specificity of their social structure and skill levels.

All of the issues mentioned here, including the encouragement of more socially friendly management practices in the host countries, remain urgent topics for debate in the agendas of international organisations, taking into consideration that there are tremendous barriers to real enforcement of such rules. The voluntary nature of most of these rules confirms the extreme difficulty in defining and enforcing *global social rules* when the institutions that undertake monitoring and supervision are still national (or regional) institutions. International law is still in an experimental stage: the extent to which international organisations have the authority to enforce such rules while relying on the still weak national institutions in developing countries (and especially in the LDCs) represents a great challenge for the future.

3.3. International donor strategy addressing the structural issues

International aid can have positive multiplier effects only if sound reform policies are put into place within the host countries. Aid should not subsidise activities, but provide a boost to dynamic programmes for improving economic activities. Thus aid should aim at improving the quality of the factors, whether labour resources, institutional capacity, and public policy formulation and regulation, but should not substitute the local actors, either public or private.

There is growing agreement among international organisations (World Bank, European Union, UNCTAD, UNDP, World Trade Organisation, etc.) in recognising the importance of the shift from the traditional “aid support”– which did not always induce improvement of the local factors in stimulating growth, but often perpetuated the passive behaviour of the local government and population in “relying on external aid” – toward more active agreements that encourage the pursuit of reforms inside the country, helping to create more endogenous capacities, thus improving the conditions for investment attraction capacity including FDI.

- Sustaining the development of endogenous capacities requires full co-operation of developing countries. Assistance not accompanied by political willingness, capacity and capability of the governments concerned is inevitably condemned to failure: the relationship between inward contribution and indigenous capability emerges as a pivotal factor in inducing development. There is a need for greater policy effectiveness in the Developing Countries and especially in the LDCs. Building and upgrading institutional capacity is a high priority in allowing developing countries' governments to be able to effectively identify their own path toward development, on the basis of their own priorities.

- There is an increasing recognition that social organisations such as non-governmental organisations (NGOs), women’s groups, trade unions, youth groups, farmers’ associations, and the private sector can play a fundamental role in mobilising human resources for taking initiatives, including economic activities, from below. The strengthening of the social partnership to achieve a greater social cohesion is critical also in facilitating diffusion of information, networks and social awareness of the problems that affect the local communities, but also potential business opportunities that might arise in the local market.

- *Private sector development,* in addition to the strengthening of institutional capacity, is becoming the core of the new approach (World Bank, 1995; IFC, 2000; UNCTAD-Norway Royal Ministry, 2001), with particular attention to the LDCs. More effective public reform policies, in particular limiting domestic monopolies and enforcing more transparent competition rules, need to be pursued, in order to accelerate the restructuring of the domestic economy and sustain the emergence of small private businesses. Improved access to financial services for SMEs, the upgrading of the basic skills of potential entrepreneurs, and the provision of basic services to SMEs are crucial in enhancing business conditions for small firms. The development of SMEs responds to dual targets: the creation of new employment, thus generating new revenues and combating poverty and addressing the more locally based needs for services or manufacturing. SME development could also initiate a process toward diversification of the local economy, in particular in development of the tertiary sector. The role of FDI could be essential in stimulating the development of sub-contractor firms, helping SMEs acquire basic technologies and new skills. This calls for an approach by TNCs that is more oriented towards the local economy and society.

- *Upgrading human capital* is one of the basic conditions for improving domestic competitive capacities, but also a relevant factor in attracting FDI: in light of the successful development strategies put into action by some developing countries (India is a well-known case), it is becoming evident that there exists great potential for the improvement of these resources, also taking into consideration the tremendous demographic growth in these countries. The possible inducement of a "virtuous circle" (OECD, 2001), reflecting the positive correlation between the upgrading of human capital quality and FDI, could increase potential for development. Education and training need to be well tailored to local requirements.

- Building an effective capacity to absorb *new technologies*, in particular *information technologies (IT)*, could help to improve information and knowledge diffusion (Pigato M., 2001; UNDP, 2001; World Bank, 2001) between countries and also within more peripheral areas with limited urban networks. The relatively simplified skill requirements for managing IT, in particular Internet, fax and personal computers, have opened up new opportunities for developing countries to improve their communications and informational capacities and in particular facilitating their access to market information. The construction of telecommunications infrastructures in developing countries has facilitated the spread of IT, and has also provided opportunities for foreign investors and local companies to work together. Of course there are still many constraints that have social and economic origins, like cultural rigidities vis-à-vis acceptance of such technologies, when the more informal networks linked to family, friends, and local community based on trust, are considered the natural horizon for social interaction. There remain serious gaps in the telephone and power networks in rural areas and financial constraints in investment capacity. However, the potential benefit of the introduction of such technologies could be enormous, speeding up a process of information diffusion that would have required much more time a few decades ago.

Box 4

Some international donor initiatives

Only a few of the main donor efforts are mentioned below:

(i) The increased sensitivity of the LDCs to trade barriers has been addressed by the initiative called the Integrated Framework (IF) that was established in 1996 with joint support from the WTO, IMF, World Bank, UNDP, UNCTAD and the International Trade Centre. However, the co-ordination among the various international agencies still needs to become more effective in delivering the technical assistance, as after a few years of operation various difficulties in implementing aid in an efficient coordinated manner became evident;

(ii) An agreement signed in 2001 between the EU and UNCTAD, the first such initiative between these organisations, provided a fund for the organisation of a Conference addressing the problem of political and social participation in LDCs;

(iii) UNDP and World Bank joint action for sustaining the "Digital Opportunity Task Force" for the rapid diffusion of information and communication technologies;

(iv) The EU initiative "Everything but Arms" (EBA) focused on the LDCs and seeks to eliminate trade barriers to LDC exports to European markets of all products other than armaments. This initiative will be followed by bilateral agreement (BITs) between LDCs and developed countries to ease export access;

(v) WTO Technical Assistance confirms the strong relationship between the respect of trade rules and the capacity to manage legal and normative regulations in the implementation of the WTO trade provisions. Thus, the competencies of the institutions and officials that are in charge of trade and international regulations in the developing countries need to be upgraded;

(vi) The World Bank "Social Capital" initiative confirms the innovative approach to addressing political and cultural conditions in improving the capacity of the poor countries for sustaining development. The strengthening of the NGOs and all social and local actors that need to be mobilised and engaged in networking to sustain locally based initiatives is considered essential in generating sustainable development;

(vii) The World Bank and IMF "Poverty reduction strategy" that covers a wide range of initiatives ranging from aid provisions to programmes for sustaining public sector reform as well as enhancing private sector development;

(viii) UNDP promotes a broader poverty reduction strategy aimed at the strengthening of central and decentralised governments, also targeted to improving policy effectiveness and political institutionalisation of the reform process;

(ix) The OECD/DAC strategy "Shaping the 21st Century: the Contribution to Development Co-operation", based on partnership and co-operation, led by developing countries' governments and representatives from civil society.

The multiplicity of programmes and initiatives has led to a strong convergence of efforts and requires increasing co-operation among the international organisations that are engaged in supporting sustainable development; however, concerns have arisen regarding aid co-ordination and effectiveness. The complexity of the policy implications, the large numbers of institutional and social actors involved, both locally and internationally, seriously complicate the efforts to increase efficiency.

The monitoring and evaluation activities that are involved in all projects of technical assistance or aid delivery are becoming an increasingly important instrument for limiting donor-assistance failure or low effectiveness. However, the challenges remain great and the process is made more difficult by the complexity of the domestic (political and social) conditions existing in each country. The increasing marginalisation of the LDCs over the past few decades has proved that there are still many issues open to debate and that there still remain tremendous gaps between aid assistance efforts and the additional requirements of developing countries. FDI could become a powerful instrument in stimulating the development process if the firms would engage in a more socially responsible pro-development approach.

4. THE CASE STUDIES: MAURITIUS, MADAGASCAR AND GHANA. THE SPECIFICITY AND LESSONS TO BE LEARNT

The countries selected for the case studies are Mauritius, Madagascar and Ghana. These provide an opportunity to investigate a variety of different conditions affecting the FDI experience within the ACP: all three have made important recent changes in their policies toward FDI and are in or located near Africa.

- **Mauritius** has followed a path of development linked to particularities of its situation as a small island state. With its specific conditions (limited land area and natural resources, small population size and large distance from main export markets), it represents an interesting case in which government policy is strongly committed to sustaining development has allowed it to achieve a relatively high per capita income and become a lower-middle income country. Mauritius has selected a unique path which aims at promoting the country's transition to an *"intelligent"* island with an economy oriented towards a *high value base*. Since the 1970s it has diversified from a mono-crop industry to an industrial economy and is now developing higher value-added sectors: IT and offshore financial services as well as tourism. The challenge for Mauritius will be to sustain this development path in the face of global economic slowdown, while at the same time maintaining its greatest natural resource: the natural beauty of the environment;

- **Madagascar** represents a very poor country with a pro-business policy and significantly under-exploited potential. The country furthermore has a unique and highly vulnerable natural environment that could be irreparably damaged by certain types of investment. Despite promising potential for economic development based on plentiful natural resources, a particular geographic location and abundant labour resources, Madagascar has not been able to secure sufficient FDI to allow the economy to take off and effectively combat poverty. This is quite an interesting contrast to Mauritius, which in the 1970s had few comparative advantages, yet was able to raise itself to lower middle-income status. Madagascar has not yet been able to follow the path of sustainable growth; however, the economic indicators of the past three years suggest that the country's economy is improving and that FDI is increasing;

- **Ghana** represents a resource-rich country that has undergone important macro-economic reform programmes (including liberalisation of trade and investment regimes) and has achieved some positive results in macroeconomic performance, improving the business environment in general as well as its policies toward extraction activities. The attempt to shift away from *traditional primary resource-based exports* toward *non-traditional sectors* has not been completely successful. Efforts to develop activities with greater value, in particular cocoa and wood-processing, have not yet reached sustainable levels and the country faces increasing competition for investment with other African countries that have recently instituted very aggressive policies to attract investment. The new Government has a difficult task ahead in trying to stabilise its macroeconomic development following a serious decline in the terms of trade and growing debt.

Below are presented the basic indicators of the selected countries, permitting a comparative overview of the three different countries.

Basic Indicators. Three case studies: Madagascar, Mauritius, Ghana

Indicators	Madagascar	Mauritius	Ghana
Population (mill.) 2000	15.5	1.2	19.2
Population growth (% p.a.)	3.1	1.3	2.2
Area (1000 km2)	587	2	239
GNI per capita (current US$) 2000; Atlas method	$260.0	$3,800	$350.0
GNP measured at PPP[24] **(1999)**	US$ 11.5 billion	US$10.1 billion	US$ 34.0
GNP per capita measured at PPP (1999)	US$ 766	US$8,652	US$1,793
GDP current $ (2000)	US$ 4.0 billion	US$ 4.5 billion	US$ 5.4 billion
GNP (1999)	US$ 3.7 billion	US$ 4.2 billion	US$ 7.4 billion
GDP growth (2000) **Annual %**	4.8%	8.6%	4.0%
average annual % growth GDP 1980-90	1.1%		3.0%
average annual % growth GDP 1990-99	1.7%		4.3%
HDI (UNDP indicator) **years**	0 483	0 761	0 556
HDI Ranking	141	71	129
Gross domestic investment 1990-99 **Average annual % growth**	0.9		4.2
FDI net inflows 1999 (WDI, current US$)	US$58.0 million	US$49.4 million	US$17.0 million
FDI net inflows 1996 (WDI, current US$)	US$10.0 million	US$ 36.7 million	US$120.0 million

[24] Purchasing power parity

Integration of FDI and multiplier effects in the domestic economy (spin-off, technology transfer, know-how environment matters etc.)	Relative good diffusion of the gains from exports and diversification of the economic activities, facilitated also by the small size and favourable business environment	Effects of FDI have not yet had much of an impact on the economy due to recentness of change in conditions.	Despite good relative macro-economic results, problems of dependence on natural resources (cocoa, timber) and minerals (mainly gold) remain. Attempt to shift toward IT sector and services has had some success.
Conditions affecting FDI qualitative features / incentives / policy measures / legal aspects, etc.	Government discretion	Recent efforts to attract investment are stymied by poorly developed infra-structure and land-ownership issues.	Pro-business environment, practically no restrictions
Multinational, Bilateral or Regional Agreements	WTO, ACP-EU, IOC, COMESA, IOR-ARC, USA (Africa Trade Bill), France	SADC, WTO, ACP, COMESA, IOC, IOR-ARC, USA Africa Trade and Development Act, France	ECOWAS, WTO, ACP-EU Partnership agreement Germany, USA, Malaysia, Czech Republic, Côte d'Ivoire

HDI comes from the UNDP's 2000 *Human Development Report*.
Sources: The World Bank Group, *World Development Report 2001*, Statistical annexes.

4.1. Mauritius

4.1.1. Country profile

Despite the fact that the country is a small island state with very limited resources, Mauritius has enjoyed two decades of high economic growth [25], leading to rapidly rising living standards [26]. The country's successful development strategy allowed it to transform itself from a mono-culture commodity exporter to the leading manufacturing exporter in sub-Saharan Africa[27]. The total amount of FDI was small, yet played a pivotal role in the development of the economy.

Up to the 1970s, Mauritius was more or less a mono-commodity economy oriented toward the production and export of sugar, vulnerable to the vagaries of the international sugar market. The country suffered from high unemployment. This situation changed in the 1980s, when the economy diversified toward textiles and garment manufacturing and tourism. While Mauritius did not attract significant amounts of FDI [28], representing less than 3% of annual capital formation during that period, two-thirds of it went to the export processing zones (EPZ), thus providing an important stimulus for diversification [29]. More recently the country has become a regional centre for financial and business services

Textiles remain the single most important activity for Mauritius, but agriculture continues to be a substantial provider of employment, while financial services are expanding rapidly and may soon make a larger contribution to the economy than tourism. The government is now targeting the development of IT activities, also to stimulate FDI. Manufacturing accounted for about a quarter of economic output in the late 1990s and accounted for an even larger share of employment. The diversification that accompanied FDI has generated significant labour-intensive, low-wage activities, yet wages have increased over time and have not been offset by productivity gains, thus eroding competitiveness. The emergence of lower wage producers in the region has presented serious challenges to the competitiveness of the EPZ-based activities.

In the 1990s, local Mauritius investors expanded their activities abroad, primarily to Africa and the Indian Ocean region, to take advantage of new market opportunities (such as banking, telecommunication, insurance and tourism): Others sought lower labour costs (textile companies have relocated to Madagascar), and yet others exported their expertise [30]. In some years investment outflows exceeded FDI inflows.

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[25] 6% annually on average. In the year from July 2000 to June 2001, overall GDP rose by 8.7%.

[26] The country reached US$4 000 per capita income in 1998. During this period, "income distribution improved while socio-economic benefits such as education, health services and housing amenities reached virtually everyone" (ILO, 1998).

[27] UNCTAD, 2001.

[28] On average US$10 million annually during 1980-89 and US$38 million annually over the 1990-98 period.

[29] During 1990-98, most of the FDI came from Asia (Singapore, India, Malaysia, Hong-Kong) and France.

[30] Such as in the sugar industry rehabilitation in mainland Africa.

4.1.2. FDI policy: strengths and weaknesses

Due to an outstanding record of political stability and a generally good business environment [31], institutional investors have given Mauritius the highest credit rating in Africa, yet stability alone does not attract FDI. Mauritius sought to attract FDI via a number of incentives [32]. However, some incentives did not yield the expected results because they were inappropriate to the Mauritian case or were poorly managed. As a consequence, the role of centralised entities, such as the new *Board of Investment (BOI),* in managing and implementing the promotion of FDI has now become more important. To date, Mauritius authorities retain complete control and discretion over investment since eligibility criteria are only vaguely defined and all FDI requires prior approval [33].

- The first and most important strategic step, inspired by examples from East Asia, was the *Export Processing Act (1970),* establishing the first *Export Processing Zone (EPZ)* in Africa. In the 1980s the EPZ permitted FDI to take advantage of local conditions (safe and good living standards, cheap labour, etc.) [34], while also gaining preferential access to the European market. In 1990, the *EPZ Development Authority* was set up to facilitate investment and ensure the competitiveness of all export-oriented activities in the EPZ, followed in 1992 by the establishment of the *Mauritius Freeport Authority,* set up to manage a freeport associated with the EPZ for the transhipment of goods;
- In 1974, Mauritius passed the *Development Incentive Act* in order to promote import substitution in manufacturing; however, this made little sense for the tiny Mauritian market and was repealed in 2000;
- While the development of offshore banking and business services [35] was launched in 1989, it was given a major impetus in 1992 with the establishment of the *Mauritius Offshore Business Activities Authority*. The financial services sector has already grown to account for a substantial share of GDP [36] and is likely to grow further if

[31] Law and order prevail, while living standards are high compared to the rest of Africa with well-developed amenities and infrastructure.
[32] Export-oriented companies in fishing and services as well as tourism, manufacturing (except beer and soft drinks) and non-traditional agriculture benefit from a reduced corporate tax rate of 15%. Regional headquarters benefit from a 10 year tax holiday on overseas income. Exporting companies are exempted from paying taxes and duties on imports of raw materials and at least some equipment, and are exempted from taxes on shareholders' dividends for 10 years. In some cases, two expatriate staff members are exempted from paying personal income taxes. The permanent resident scheme permits foreign investors to acquire local nationality by investing US$500,000 either in a business or in certain investment funds.
[33] This has attracted criticism, though in a very small developing country such as Mauritius such an approach may be required to avoid the economy being dominated by large foreign companies.
[34] Intermediate goods and components were imported from Asia, processed in Mauritius and then re-exported mostly to Africa, while companies operating in this zone were exempted from income taxes, customs duties and other taxes on capital items and re-exports. Warehousing and storage is subsidised.
[35] Mauritius is now home to various management companies and corporate service trusts, aircraft and ship leasing and financing companies, international traders, investment advisers, asset managers and captive insurance (self-insurance) providers, offering a broad range of services and operating within a well-regulated and supervised environment.
[36] 16% in 1999.

Mauritius is successful in its strategy to become the regional offshore hub for the Indian Ocean Rim and Africa [37].

- The *Industrial Expansion Act (1993)* provided incentives for certain activities, but eventually the Government was pressured to grant these incentives throughout the economy, even to bus and casino operators [38].

- In 1998, the Mauritius Government decided to offer *Regional Development Certificates* to encourage outward investment by companies [39] whose equity was at least partially owned by a Mauritian (minimum 35%).

- In December 2000, the *Investment Promotion Act,* leading to the creation of the *Board of Investment (BOI),* was passed. The BOI is to promote and facilitate FDI as well as approve FDI project proposals. Its objectives are to promote Mauritius as an international business and service centre, assist in the upgrading of Mauritian industry and attract high technology investments.

Box 5

Effects and distortions associated with the Export Processing Zone (EPZ)

The EPZ free-zone concept grants statutory and tax benefits to export-oriented companies located anywhere in the country. FDI, primarily from Asia, was attracted by these incentives and Mauritius' preferential access to the markets of the EU and USA under the *Multifibre Arrangement* quota system.

Under the EPZ concept, textiles rapidly became a pillar of the economy, making a substantial contribution to GDP and providing work for more than 90,000 people. Textile exports increased sharply and now represent about half of total exports. Mauritius has performed particularly well in the highly competitive world garment market [13] and is the second largest world exporter of the "woolmark" label (ILO, 1998).

While Mauritius has benefited from FDI in textiles, there has been little upgrading of investment toward producing higher value products and, as productivity gains have not offset wage increases, Mauritius is progressively pricing itself out of the market. Furthermore, the Multifibre Arrangement will be dismantled in 2004, requiring Mauritius to adjust to the challenges this represents. The recent discussion with South Korea to integrate the textile sector vertically and improve the productivity and quality of the products could revitalise the sector, but such reform comes late and will not be achieved without pain.

[13] "Mauritius has outperformed other exporters in the expanding segment of the garment market, both inner and outer garments…and also gained market share in the shrinking segment of the market, namely denim fabrics, yarn combed wool and women/girls blouses and shirts made of cotton. Overall, Mauritius' exports are mainly winners with very few losers" (UN, 2001).

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[37] In the 1990s an attempt was also made to stimulate the domestic capital market by encouraging companies to list on the stock exchange, yet ownership generally did not change hands and therefore the market remained relatively inactive, while proving costly to the government (in that companies benefited from incentives which meant foregone revenues for the Government).

[38] This proved to be counterproductive as it did not promote additional investment and was costly in terms foregone tax revenues for the Government.

[39] Companies pay a reduced corporate tax of 15% and are exempted from income tax on overseas dividends.

4.1.3. Bilateral, regional, multilateral agreements

Mauritius has signed 24 Bilateral Taxation Treaties and 13 Bilateral Investment Treaties. Six more are in the pipeline. Investors not covered by these treaties have to rely on the good track record of the Government of Mauritius, since no foreign investment law exists to lay down basic principles with regards to fund repatriation, nationalisation, etc.

Preferential access to important export markets and a high level of regional integration are important in attracting FDI. Mauritius has preferential trade access to the EU (Lomé and Cotonou Agreements) and the USA (Africa Trade and Development Act, May 2000). Furthermore, Mauritius fought hard to get the best possible deals within the framework of the Sugar Protocol and textile quotas under the Multifibre Arrangement.

Mauritius is part of four regional groupings: SADC (Southern African Development Community), COMESA (Common Market for Eastern and Southern Africa), IOC (Indian Ocean Commission) and IOR-ARC (Indian Ocean Rim-Association for Regional Co-operation). Participation in these groups is important for Mauritius' future as an exporter, in particular with regard to negotiations with the EU on preferred trade access. In about 20 years most products entering Mauritius will be duty free, while at the same time privileged access to key markets will either have disappeared or be insignificant, a dramatic change that will need to be managed carefully.

4.1.4. FDI targets

The objectives of FDI attraction in the past were to diversify the economy, stimulate growth and increase employment. More recently the focus is on raising value added as well as skill and technology levels. To help attract FDI, the Government of Mauritius seeks to develop a new IT sector, aimed at transforming Mauritius into a cyber-island in four consecutive phases, by:

- spreading the use of ICT throughout the country and developing a cyber-culture at all levels [40];
- developing world class infrastructure and providing the necessary connectivity to the International Framework;
- promoting the application of IT knowledge to add value to what the country produces;
- implementing a dynamic ICT industry and knowledge-based activities.

[40] The IVTB (Industrial and Vocational Training Board) has been entrusted to train some 1500 HSC School leavers to study basic information technology and to acquire skills related to call centres facilities (languages, telephone skills), web imaging, graphic design, and multimedia production.

4.1.5. Barriers to FDI

There are a number of factors that constitute potential barriers to FDI, including the following:

- *Small local market size:* This can be overcome only by focusing on certain comparative advantages such as preferential trade agreements with major export markets or highlighting the regional potential of the country;

- *Investment approval:* All FDI projects in Mauritius require prior approval, complicated by the fact that criteria for approval are unpublished and screening takes place in a non-transparent manner. In theory, there are no restrictions as to type of FDI, but in practice export-oriented activities, large investments and joint ventures with local partners are favoured [41]. With rare recent exceptions, investments in public utilities and services ranging from electricity generation to ports are reserved to the Mauritius State. Gaining permits and licences from local authorities can take up to three months, though the situation has apparently recently improved. While FDI in tourism was welcomed, allowing tourism to play a major role in the economy, restrictions were suddenly imposed [42];

- *Level of education:* To prevent an erosion of the competitiveness of the economy, some fundamental changes are needed in the education system, especially at the tertiary level [43;]

- *High utility costs:* The cost of certain utilities, such as telecommunications, is extremely high, constituting a financial burden on companies operating in Mauritius, especially in the offshore business and service centre [44];

- *Environmental* regulations imposed by the Government have become much more stringent with time in order to minimise the impact of tourism on the environment (water, soil, etc.) [45].

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[41] Traditional activities and services such as construction or duty free shops are discouraged.

[42] About 10 years ago the Government feared that over-capacity in hotel rooms was developing and introduced restrictions on new investments: 100% foreign ownership of new developments was permitted only for large hotels with more than 100 rooms. Foreign participation in smaller hotels was restricted to 49%. There are no restrictions on FDI for hotel management companies; but the remainder of the tourist sector is almost entirely reserved to national investors, excluding foreign participation from travel agencies, tour operators, tourist guides, car rental, yacht charters and duty free shops. Nevertheless, the tourist market has grown rapidly and there has been significant investment in new hotels by both national and foreign investors. "Approximately 40% of the 25 larger hotels (with more than a 100 rooms) are partly foreign owned. Most major restaurant and car rental chains are represented through franchises or agencies" (UN, 2001).

[43] Primary and secondary school enrolment ratios in Mauritius are in line with those of the Asian "Tigers" but at the tertiary level Mauritius has an enrolment rate nearly three times lower.

[44] It is hoped that the proposed acquisition of a substantial portion of the Mauritius telecommunication company by a private sector company will address this issue.

[45] The sustainability of tourism is based mainly on the natural beauty of the environment. About half of the funds under the 8 th European Development Fund, National Indicative Programme signed February 1997 were earmarked for the environment to reverse coastal water pollution and the resulting degradation of the barrier reefs and aquifers, which are a major source of drinking water.

4.1.6. Impact of FDI on domestic economy development

Mauritius has managed to maintain social cohesion and stability during the period of substantial economic changes [46]. Thus, from a social perspective, it can be argued that the impact of FDI has been more or less positive, reinforced by the creation of employment and significant improvement of services and infrastructure.

The total amount of FDI inflows to Mauritius has not been large [47], although in per capita terms it is not negligible – between US$10 to US$20 annually during the last two decades – and it provided the stimulus for diversification of the economy. While it is difficult to distinguish the results linked to FDI from those associated with other factors (i.e. domestic private investment, which played a significant role), annual GDP growth averaged about 6% over the last two decades and Mauritius is now a middle income country. The positive effects of diversification and spin-offs related to FDI have pervaded throughout the economy, facilitated by its small size. Tourism and offshore services had spin-off effects in areas such as telecommunication, real estate and agriculture and provided joint venture opportunities to local companies. The contribution of manufacturing to GDP has not only doubled but focused production on exports instead of the local market, replacing sugar as the leading export.

Unemployment, which exceeded 20% in the 1970s, was reduced to around 3% in the late 1980s. In recent years unemployment has increased somewhat, reaching 6.4% in 1999. As a result of the economic diversification and the EPZ policies, by 1999 some 90,000 jobs (80% in textiles) were created within the EPZ and more than 17,000 jobs were generated in the tourism industry. Trade-related activities employ an estimated 20% of the active population. Offshore services now offer opportunities in highly specialised professional positions, yet insufficient enrolment in tertiary education will make it increasingly difficult to fill these positions.

An important impact of FDI in Mauritius has been in the transfer of novel ideas, processes, managerial skills and technology to the economy and particular companies. In the textiles industry, foreign companies established close linkages with local companies performing specialised services ranging from embroidery to packaging, transport, etc. It has to be noted, however, that the main EPZ exporters of textiles today are local companies and Mauritius is now exporting to the rest of Africa the expertise it has gained in this industry and is even relocating some of these activities overseas [48].

[46] "Income distribution improved while socio-economic benefits such as education, health services and housing amenities reach virtually everyone" (ILO, 1998).
[47] It needs to be noted that offshore services are not recorded as FDI.
[48] The increase in wages has eroded the comparative advantage of Mauritius in the textiles sector and the industry will continue relocating overseas unless productivity gains can be secured or a high value market niche market can be exploited.

4.1.7. Conclusions

As a middle-income country, Mauritius now faces very different challenges from the past. In a slowing global economy and with rising labour costs, the country must find new competitive advantages both in existing industries and new activities, such as regional business and financial services. FDI is likely to continue to play a role in manufacturing joint ventures and in tourism. Increases in efficiency and upgrading of production capacities in established industries will be crucial in maintaining the gains it made over the past two decades. To promote future sustainable development, there is a need for activities generating higher value added and investment in technical education is required to train highly skilled professionals to sustain the new phase of development in which Mauritius wants to move.

A number of lessons can be learned from the Mauritius experience:

- Even a small country with limited natural resources can successfully attract FDI by creating an appropriate incentive program and business environment. The export development strategy in East Asia can provide a valuable model in planning economic development, including investment;

- Centralisation of the implementing authorities (i.e. BOI) providing incentives promotes greater efficiency and coherency;

- Non-transparent policy may not be such major deterrent to FDI while providing a beneficial function in protecting developing economies, especially in countries as small and vulnerable as Mauritius.

4.2 Madagascar

4.2.1. Country profile

Madagascar is one of the least developed countries in the world, with a GNP per capita of US$250 and a population growth rate of 3% annually. A large share of the population lives below the poverty line, with appalling food, education and health conditions. This situation dates back to the mid-1970s, when the socialist management of the economy and the nationalisation of all foreign-owned assets bankrupted the country.

During the 1980s, the Government embarked on a number of financial stabilisation programmes supported by the World Bank and the IMF. During the early 1990s, the transitional Government introduced a number of reforms: price and import controls were partly removed and export taxes were abolished; however, these measures, introduced in a troubled economic and political environment, did not yield the expected results. Instead, the exchange rate depreciated severely, inflation rose sharply, substantial arrears built up and poverty grew.

In recent years, the macro-economic situation of the country has improved marginally. The Government is gaining back the confidence of donors and the private sector and is following policies to liberalise and stabilise the economic situation. GDP has grown

over 4% annually during the last 3 years (exceeding the 3% rate of population growth), inflation is under control (below 10% in 1998 and 1999) and the foreign reserves are increasing. However, necessary fiscal reforms to balance the Government's budget will impact on the purchasing power of the populations and social unrest can be expected as a consequence of rising taxes.

Madagascar has many resources that remain under-exploited, mainly in agriculture [49], fishing, mining, tourism, and industry (textiles and agro-industry) as well as in new technologies, information and communication. Substantial export potential exists in food crops[50] and fishing[51]. *Mining* is considered a priority sector in the economic development strategy of the country, yet any expansion of such activities [52] must be very carefully considered in terms of environmental and social impact. *Tourism* potential is very important, not only because of the natural beauty of the island (beaches, fauna, flora, etc.), but also because it belongs to the IOC region, which is already a well-developed tourist destination.

Industry is not very diversified and many companies operate with obsolete equipment. Enterprises in the *free zone* are predominantly in textiles, garments and new technologies. Free zone companies, benefiting from extremely low wages, generate an increasing number of formal jobs (45,000 in 1999) and now account for 40% of exports.

4.2.2. FDI policy: Strengths and weaknesses

In its economic policy framework for 1996-1999, the Government's primary objective was to win the trust of the public and economic agents in a liberalised and stable economic environment and to establish an effective State which is able to improve the investment climate and combat poverty vigorously. With regards to FDI promotion, the Government sought first and foremost to regain the trust of foreign investors. This trust had completely disappeared, initially as a result of nationalisation and expropriation without compensation and later due to the lack of credibility in the economic policies of the 1980-90 period.

Pressured by the major donors (World Bank, IMF, European Union, and France), Madagascar has now embarked on an extensive economic reform programme, including the reform of public services (tribunals, customs and excise, fiscal revenue), privatisation of State enterprises, infrastructure development, improved competition, good governance and the respect of law. Still, a number of reforms need to be carried in more effective way: in particular the implementation of the enterprise privatisation programme is severely behind schedule, jeopardising the profitability of these companies and the investment interest of potential investors.

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[49] Agriculture contributes 30% of GDP and employs 80% of the labour force.

[50] Rice, corn, coffee, vanilla, cloves, aromatic plants, fruit and vegetables, sugar cane, biological products.

[51] Fishing (particularly shrimp) is the second largest export earner and could be developed considerably with the introduction of a more transparent policy as regards to licensing.

[52] Formal and informal companies mine mica, graphite, quartz, chrome, gold and precious stones, practically all of which are exported.

The main factors favouring the development of FDI in Madagascar are the following:

- Agriculture has good potential due to the size of the country and the variety of climates. The same goes for fishing;
- Madagascar has promising mining and energy potential and has recently introduced a new mining code;
- The tertiary sector comprises important potential, particularly in tourism, new information and communication technologies.
- The availability of an abundant and cheap labour resources.
- Indications of an improving economic situation and privatisation prospects of the large semi-public enterprises in transport, telecommunication, water supply, electricity and industry;
- Membership of Madagascar in various regional groupings such as COMESA, IOC and IOR-ARC.

One of the most important measures introduced to promote investment was the creation in 1989 of a *Free Economic Zone* (FEZ) and the introduction of a one-stop-shop for all *free-zone* formalities as well as an investors' promotion area to welcome and provide information to investors. The free zone investment code was introduced in 1989 and grants preferential treatment to export-oriented companies: reduced corporate tax rates and exemption from taxes and duties on imports and exports. These incentives are granted for a period of two to fifteen years, depending on the type of activity.

While the 1989 “investment code” for the FEZ foresaw the existence of dual legal systems governing investments, one for the FEZ and another for the rest of the country, in 1996 this policy was revoked. Foreign investors can now invest freely throughout the national territory and are subject to the same fiscal conditions as any local investors, in which local law is applicable and specific incentives are no longer granted.

4.2.3. Bilateral, regional and multilateral agreements:

Preferential access to significant export markets and good regional integration contributes to attracting FDI. Madagascar is a signatory of the new ACP-EU Cotonou Agreement and benefits to date from preferential access to the EU market. [53] The same is true for the USA with the Africa Trade Bill. The country is also a member of three regional groupings: the Indian Ocean Commission (IOC), the Common Market of East and Southern Africa (COMESA) and the Indian Ocean Rim – Association for Regional Cooperation (IOR-ARC) and has preferential access to these markets. It is interesting to note that COMESA is putting in place, with the support of the World Bank and European Commission, a *common regional investment framework*. This regional approach should encourage member countries to accelerate the introduction of institutions and regulations to facilitate FDI throughout the COMESA.

[53] for exports of shrimp as well as fruits, vegetables, etc.

4.2.4. FDI targets

FDI targets are not explicitly spelled out in the economic policy documents of the country, except within the context of the global poverty reduction objective. The new framework for economic policy adopted for the period 1999-2001 set three main objectives:

- Good governance
- Combating poverty and exclusion
- Strengthening of productive capacities

It is in this framework, that Madagascar is putting into place a *national programme* supporting the development of a competitive private sector in order to create employment. FDI is seen as an important contributor to job creation and increased revenues; development of productive activities in rural areas, including agriculture, tourism, and fishing; and promotion of exports. The *Free Economic Zone* addresses two important aims: increasing exports and reducing unemployment.

4.2.5. Barriers to FDI

Obstacles to the development of FDI are numerous in Madagascar. One of the major constraints to the development of many of the promising sectors is the *underdeveloped infrastructure*, especially the road system, preventing products from being efficiently transported to markets and port areas [54]. This has also impeded the construction of tourist infrastructure. Since international donors are the main providers of funds for infrastructure development, complex decision procedures have delayed the implementation of these urgently needed projects. The poor condition of the infrastructure is aggravated by frequent cyclones and heavy rains. On the other hand, the development of an adequate transport structure also raises serious *environmental concerns*, which must be carefully considered in any such projects, weighing the costs and benefits of development versus preserving the unique natural environment [55].

Further obstacles to investment include barriers in the country's regulatory framework. Within the non-transparent fiscal regime, various regulations co-exist. The country's complex business law needs to be revamped, tribunals do not operate effectively and the issue of land ownership is problematic. For example, title deeds offer little security to investors since ownership can always be challenged. Since 1995, foreigners are not allowed to acquire real estate; though it is possible to enter a 99-year long lease. The land property office has experienced decades of severe mismanagement and it is not unusual that several owners in possession of title deeds claim ownership to the same plot of land. The Government is trying to the resolve the land title issue, but it will take years

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[54] Lack of adequate transport infrastructure is a serious constraint to development of the interior areas of the country.

[55] Madagascar has a unique ecosystem that is home to plants and animals not found anywhere else, constituting a tremendous resource not only for tourism but also for the study of flora and fauna and the potential discovery of valuable medicinal plants.

to reorganise this office, preventing much-needed investment in tourism and in agriculture.

The business environment is further complicated by the following:

- Insufficient training centres force companies to provide in-house professional training which is costly and risky (losing trained staff to the competition);
- The lack of trust of investors has not been overcome, with many compensation claims relating to the nationalisation of the 1970s still pending;
- Business activities suffer unfair competition from the extremely active informal sector;
- Socio-cultural constraints include resistance to change, complex decision procedures resulting in cumbersome administration procedures, ethnic tensions and corruption;
- Shortage of local finance for investment is problematic for local investors in need of adapted financial tools, refinancing possibilities, a stock-market, a guarantee fund and funds for studies.
- The level of external debt is seen by some investors as problematic.

Box 6

Historical and cultural obstacles to FDI development in Madagascar

Local culture takes from Madagascar's ancient traditions a form of fatalism and a concept of community life, which are difficult to reconcile with the present economic liberalisation. Company management has tended to be more social than economic and the notion of wages linked to productivity is not part of the work ethic. This is combined with the legacy of socialist control of the economy where the State was a major provider of jobs and former colonisers and foreign investors were not well considered. It is therefore not surprising that Malagasy people are reserved vis-à-vis foreigners and are not inclined to open the capital of their companies to foreign partners for fear of losing control over their economic and social assets. However, with the arrival of young entrepreneurs for whom modern management has no secrets, attitudes are changing.

The Malagasy private sector has been very active in recent years in the economic policy debate, most notably within the Competition Reflection Committee, which is the formal framework for consultation between the private sector and the authorities for the promotion of the private sector.

4.2.6. Impact of FDI on the domestic economy development

FDI flows to Madagascar have increased markedly in recent years but still represent only a small portion of all financial inflows (public and private) to the country. By comparison, the volume of development aid reached US$375 million in 1999, with US$294 million in 1998 and US$690 million in 1997 (of which US$243 million was aimed at reducing national bilateral debt). The country remains heavily dependent on international financial aid for infrastructure and social investments. Nevertheless, there seems to be a positive correlation between GDP growth and the resumption of FDI inflows since 1997.

The impact of FDI on employment generation is most visible in construction, tourism and free zone companies (principally textiles). New jobs have also been created in the new technologies. Private investments (local and foreign) have been focused on the following branches:

- Outside the free zones: beverages, construction materials, wood/timber industries, ironworking, telecommunications, banking, tourism and construction.
- Within the free zone: textiles and garments (66%), varied manufacturing (16%) and new technologies (10%).

The specialisation of FDI in Madagascar is related to the nationality of the investors, links with the country of origin and export markets. For example, French investors represent 65% of FDI investment in the country [56], principally in sugar, construction, banks, tourism and textiles (in free zones). Investments from Mauritius and Indo-Pakistani investors are mostly linked to re-location of *free zone* activities from the home countries of the investors.

Most investments are concentrated in the region around Antananarivo, the country's capital, because location in rural areas is difficult. This concentration has a perverse effect because it leads to rural exodus towards the capital with the resulting social consequences. In rural areas, there is a serious risk of depriving the rural population of their only source of revenue, the land, by the creation of large tourist resorts and agro-industrial estates. This is compounded by risks to the environment from a number of activities:

- Re-location of polluting textile companies;
- Mining activities in the informal sector, which operates outside of any regulations;
- Rapid deforestation due to lack of control over forestry activities;
- Over-exploitation of fishery resources.

It is feared that economic globalisation and the opening of the local market could bankrupt thousands of small enterprises operating on the domestic market. However, the resumption of foreign investment in the country is still too recent in order to gauge the impact (spin-off) on the local private sector and on the society at large.

[56] There were 600 French-owned companies active in Madagascar in 1999.

Box 7

Specific example of successful FDI

The "XYZ" company, owned by French investors, began its garment manufacturing activities in 1998 in a free zone. Initial investment was below Euro 50,000. By the end of 2000, investment had reached Euro 900,000 and new investments in excess of Euro 1 mill ion are expected to take place over the short term. The company exports mainly to Europe and the USA and sales are increasing exponentially. The company's staff has risen from 40 to more than 1,400 in 2000. The number of employees is expected to exceed 2,000 by the end of 2001.

Due to its adherence to local and international standards, XYZ was the first company to obtain an environmental approval by the Government of Madagascar.

This FDI is considered successful since it contributes to job creation, generates exports and respects the environment. The recent staff expansion attests also to the commercial success of the venture. The principal factors that have contributed to the development of this company are:

- The managers, who are also majority owners, are technically well qualified and very experienced in garment manufacturing;
- An excellent relationship of trust with suppliers and buyers;
- Good reputation with the foreign banks that have invested in the company;
- Competitive pricing, continuous quality control;
- Ongoing process of investment, also in new technologies;
- Intensive training programmes for trainers and staff with the support of the Centre for the Development of Enterprises (CDE ex-CDI).

4.2.7. Conclusion

It is evident that FDI is starting to contribute to formal job creation and exports, even if this role is still modest. The Government's economic policy has regained some credibility with foreign investors. However, the delay in the implementation of the privatisation programme of semi-public companies and the complex problems (real estate ownership issues, public sector ineffectiveness, insufficient infrastructure, etc.) in the business environment are still discouraging FDI and preventing a sharp upswing of FDI in Madagascar in the near future. Nevertheless, the country offers interesting opportunities for FDI with potential benefits for both investors and the national economy.

4.3 Ghana

4.3.1. Country profile

Ghana is generally regarded as a successful example of investment promotion in Africa, yet recent macroeconomic problems threaten many of the gains made in the 1990s. After nearly a decade of pro-business policies and GDP growth exceeding 4% annually [57], by late 2000, Ghana was close to financial crisis. Declines in the world cocoa market and turbulence in the gold market coupled with sharply rising oil prices have caused a slowdown in GDP growth [58] and a decline in per capita income. A sharp deterioration in the terms of trade was aggravated by the *"loose" economic policies* of the previous government prior to the elections, leading to a jump in inflation and domestic debt. Furthermore, the country had been experiencing some difficulties in attracting domestic and foreign investment capital, due to political uncertainty, growing corruption, low labour productivity and counterproductive economic policies and regulations [59]. Shortfalls and delays in aid inflows led to increased borrowing and unemployment reached new highs [60].

In the first democratic transfer of power in Ghana's history, a new Government took office in January 2001: a significant accomplishment in a region plagued by political instability and violence. The new government's first major objective is to regain *macroeconomic stability and market confidence*, including improvements to the terms of trade and reduction of debt, inflation and employment.

Over the medium term, the government seeks to diversify the economy away from traditional export sectors, cocoa, gold and timber, toward other activities (non-traditional agricultural exports, textiles and clothing manufacture, and tourism) [61], yet also to increase value-added in traditional activities. Special incentives are to be provided for value-added processing of cocoa and gold, which are the country's two main export commodities. Furthermore, efforts to develop domestic petroleum reserves and the West African Gas Pipeline as well as the West African power pool will decrease dependence on imported oil. Further government divestiture in transport, energy and banking sectors will present important opportunities for foreign investors.

The private sector and FDI in particular will play a key in Ghana's economic development over the next several years [62]. Continuing the policies of the previous government, the Kufuor Government courts foreign investors in a concerted and proactive manner, seeking to transform Ghana into a middle income country by the year

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[57] During the period 1990-1999, GDP growth had averaged 4.3% annually, up from an average increase of 3.0% in 1980-1990 (World Bank, World Development Report, 2000/2001).
[58] 1999 growth was only 4.4% instead of the projected 5.5%, and 2000 growth was 3.7% rather than 5.0% as expected under the previous government's macroeconomic plan. Budget 2001, presented 9 March 2001, Minister of Finance.
[59] USAID, "Ghana FY 2002 Congressional Budget Justification", 10 August 2001.
[60] Memorandum of Economic and Financial Policies of the Government of Ghana for 2001.
[61] Value-added processing of agricultural products has significant potential both in developing the primary sector as well as an industrial capacity to produce consumer products that can be sold domestically, regionally or distant export markets such as Europe.
[62] This point was emphasised by a recent WTO Secretariat report, February 2001.

2020[63]. The main government policy directions are outlined in the *Ghana Poverty Reduction Strategy (GPRS),* covering the period 2002-2004, a period that will be critical in reestablishing the gains made in the 1990s [64]. Regional integration within ECOWAS is seen as having an important positive effect on reducing poverty and attracting investment through allowing member economies to move toward larger and more unified markets (i.e. free trade areas, customs unions, or single markets) [65].

By the end of 2000, Ghana's public and publicly guaranteed external debt had reached US$5.9 billion[66] and was expected to increase to US$6.2 billion in 2001. Recent debt reduction efforts included withdrawing subsidies to consumers and reintroducing and raising the value-added tax. In July 2001 Ghana formally joined the World Bank's *Heavily Indebted Poor Countries (HIPC) initiative*. Ghana will benefit from a US$2.2 billion debt relief package[67], if it agrees to abide by certain conditions[68]. The controversial HIPC initiative requires effective structural reforms, macroeconomic stability, fiscal discipline and a well-conceived poverty reduction programme, necessitating a linkage between poverty reduction and debt relief efforts. The *Ghana Poverty Reduction Strategy (GPRS)* will play a key role in addressing these issues, emphasising increasing productivity at macro and micro levels and generating viable conditions for FDI, while improving the welfare of the citizens, especially the poorest elements.

Macro-economic growth has been closely linked to cocoa, gold and timber exports; consequently, Ghana has been extremely vulnerable to fluctuations in world commodity prices. Furthermore, recent rationalisations in gold mining and coffee growing have led to job cuts in these industries, affecting thousands of Ghanaians, especially workers with low-level skills.

While services now constitute the largest share of value added in GNP, agriculture remains an important mainstay of the economy. The share of industry has increased to a quarter of GNP in 1999, while the relative importance of manufacturing has declined slightly over the same period:

- *Services* form the largest share of new investments [69]. Ghana is seen as having potential to become a centre of innovation in information technology [70] and an important telecommunications hub for the region. Investment in IT services has been

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[63] "Vision 2020", a policy initiated by the previous Government.
[64] The government sees the challenge as "..an opportunity to lay the foundation for re-launching macroeconomic stability, and creating a viable and sustainable environment that will signal to the business community that Ghana is ready to do business with the world." Budget 2001, presented 9 March 2001 by Minister of Finance Yaw Osafo-Marfo.
[65] Kennes, W., "Regional dynamics in the new ACP-EU partnership", *The Courier*, Special Issue, Cotounou Agreement, p. 29, September 2000.
[66] Memorandum of Economic and Financial Policies of the Government of Ghana for 2001.
[67] Wright A., Kojo Kwarteng, E., "An Amount of $2.2 billion Debt to go", *Daily Graphic*, Monday, 9 July 2001.
[68] As a direct result of Ghana's joining the HIPC initiative, the UK, Spain, France and Italy have announced the cancellation of various debts owed by Ghana. Wright A., Lloyd E., "Ghana won't pay debt," *Daily Graphic*, 10 July 2001.
[69] between September 1994 and December 2000, services accounted for 26.83% of the number and over 55% of the value of investments.
[70] USAID, 2001.

given a boost by the IFC this year[71], contributing to Ghana's attractiveness for foreign investors[72];

- Prior to September 2001, *tourism* ranked third as a source of foreign exchange after gold and cocoa. Private investment in tourist infrastructure and superstructure will be promoted as tourism has broader potential for economic development while also contributing to protection of the natural environment and upgrading of local human resources;
- *Agriculture/forestry*: Ghana is the world's second largest producer of cocoa, the third largest producer of timber[73] and the second largest exporter of wood and wood products in Africa. Agriculture employs about 60% of Ghana's workforce, but only accounted for a small share of new investment. The economy was hit hard and the cocoa sector reached a critical state in December 2000, when world cocoa prices sunk to their lowest in three decades. Prospects for FDI in the cocoa branch are mainly limited to *cocoa processing*. FDI in large-scale cocoa cultivation constitutes a serious risk to Ghana's bean quality as well as the livelihood of a large share of the workforce[74], while making it difficult to grow organic beans, which are of growing interest to niche and fair-trade markets;
- *Mining and mineral extraction:* Mining and mineral extraction activities constitute the largest overall value of FDI in Ghana and gold is the country's second most important export after cocoa[75]. Ghana was a leader in promulgating pro-investment mining legislation that was subsequently adopted elsewhere in Africa [76]. The Minerals and Mining Law of 1986 was instrumental in attracting foreign investment of more than US$3 billion into the mining/extraction sector [77] through the end of 1997[78]. The Mining and Minerals (Amendment) Act, 1994 (Act 475) removed further obstacles to investment and reduced the corporate tax rate on mining to the level applied to other industries. However, Ghana's regulations are perceived by some as not being competitive enough: some countries, for example Tanzania, Mali

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[71] Since 1984 up to 30 June 2001, the IFC has approved US$615 million of partial financing for 30 projects in Ghana valued at US$1.23 billion.
[72] As of 30 June 2001, about two-thirds of the IFC's committed portfolio in Ghana was in information technology and telecommunications. The investment in Ghana Telecom is the IFC's largest in Sub-Saharan Africa.
[73] The timber/logging industry expanded in 2000 at 11.1%, up from, 6.9% in 1999 (2001 Budget); however there are serious environmental concerns (deforestation followed by erosion and damage to ecosystems) linked to this industry.
[74] Ghanaian beans are cultivated on small farms, using traditional, labour-intensive methods, thus yielding far higher quality beans – Ghana's competitive advantage, and permitting intercropping to reduce dependence on cocoa.
[75] Recently mining has experienced serious problems, linked to declining world commodity prices and corporate rationalisation programmes. Privatisation of mines, while attracting FDI, has led to corporate cost-cutting and thousands of job cuts. Yet mining companies have seen that larger volume output, necessitating further exploration and expansion of excavation activities, is the only way to maintain profits and are thus pressuring the Ghanaian government for more concessions to expand their scope of operations.
[76] Mallet, V., Survey Ghana Mining, *Financial Times,* 29 November 2000.
[77] Companies such as Lonmin Plc (UK), Ranger Minerals Ltd (Australia), Barnto Exploration & Golden Knight Resources (Canada), Gold Fields of South Africa and Glencar Mining (Ireland) are key players in the gold industry.
[78] Coakley, G.J., *The Mineral Industry of Ghana*, 1998.

and Guinea, have taken Ghanaian mining laws and improved on them. The government is now emphasising the exploration for and development of hydrocarbon resources[79] in order to reduce dependence on imported oil. Another effort to reduce such dependence is represented by the *West African Gas Pipeline (WAGP)* which will bring gas from Nigeria to Benin, Togo and Ghana [80].

Box 8

Gold mining: mixed results of FDI

Gold mining has been associated with various social, health and environmental [81] problems. Massive lay-offs of mine workers following privatisation of many state mines has left large pockets of regionalised unemployment and confrontations have arisen between large and small mining operations regarding land rights and compensation for use of land. Foreign firms taking over privatised government concessions in some cases have evicted farmers and local inhabitants, sometimes forcefully, with houses destroyed by armed soldiers and police. Local inhabitants have been forced to move into houses built by mining companies, for example the South African mining company, Goldfields Ghana. Many traditional people hold the view that the government favours profit over health and the environment [14], large companies over small operators, and minerals over food and biological resources and are now mobilising against the companies[15].

[14] Gold mining operations use cyanide leaching which is highly toxic to the environment and its inhabitants.
[15] In the Wassa Fiase Traditional area, the Wassa Association of Communities Affected by Mining (WACAM) seeks to help communities obtain acceptable compensation and better outcome in relocation and resettlement issues.

- *Manufacturing:* Manufacturing still represents only a small part of the economy, focusing mainly on processing of gold, mined products, and cocoa as well as import-substitution industries [82]; yet it accounted for the second largest number of new investments in the fourth quarter of 2000. Manufacturing has substantial potential,

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[79] Companies active in the oil business in Ghana include TotalElf, Mobil and Shell
[80] The offshore pipeline represents a US$400 million investment by Chevron, Shell, Nigerian Gas Corporation, the Ghana National Petroleum Company (GNPC), Société Béninoise de Gaz and Société Togolaise de Gaz.
[81] While the Environmental Protection Agency was set up in Ghana in 1994 and new mining operations are now required to undertake environmental impact studies, enforcement is often difficult. Environmental planning is now required and a share of the mining royalties are used to pay for environmental remediation.
[82] Food products, beverages, cigarettes, textiles, clothing, footwear, timber products, chemicals, steel, and pharmaceuticals.

particularly light manufacturing, aluminium [83] and food processing [84] as value-added activities evolving from the primary mining and agriculture sectors [85].

4.3.2. FDI policy: Strengths and Weaknesses

Ghana's active investment promotion policy is exemplified by *the Ghana Investment Promotion Centre (GIPC) Act of 1994*, and the *1994 Amendment to the Minerals and Mining Act.* Between September 1994 and the end of 2000 Ghana attracted over US$1.6 billion in private investment by offering various incentives [86]. Key factors in attracting investment have been a reduced role of the state in regulating companies, liberalisation of imports, and removal of currency controls. The country boasts a dynamic private sector willing to co-operate with foreign investors, a comparatively well-developed infrastructure, a fairly good education and health system, a strategic and central location, a diversified industrial base, and a stable political environment with established democratic institutions and systems. Duty free access of manufactured exports to US and EU markets and ease of visas for nationals from various industrialised countries and the RSA also facilitate foreign investments.

The main policy instruments to attract FDI are presented below:

- The mission of the *Ghana Investment Promotion Centre (GIPC)* is *"to attract private domestic and foreign investment to transform Ghana into a broad-based industrial and export-led economy though aggressive investment promotion activities"*. The Centre also coordinates and monitors all investment activities that are covered by Act. 478 and has an In-country Investors' Outreach Programme. In 1999 the GIPC launched the *Ghana Trade and Investment Gateway Programme,* aimed at promoting investment in a well-targeted manner, using private sector surveys and strategies to stimulate export-oriented activities that add value through the processing of natural resources for local and sub-regional markets;

- The *Ghana Free Zones Scheme* encourages the development of *Export Processing Zones (EPZ)* in seaport and airport areas [87]. Extensive and generous incentives have been packaged in the *Free Zones Act (1995)* for investors interested in developing and operating free-zone enclaves and single-factory free zones [88]. The *Ghana Free*

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[83] The VALCO Aluminum Smelter at Tema is owned by Kaiser and Reynolds of the USA.

[84] There is already a substantial FDI presence in food-processing: Coca Cola has two bottling plants and Nestle has a modern factory in Tema. Unilever is one of the largest employers in the country, and Fan Milk, Cadbury's and Guinness are major players in the food and beverage industry.

[85] In adding value to primary agricultural output with less environmental impact than mining and mineral/metal processing, food processing / packaging has good potential for sustainable development, in particular in the context of the larger ECOWAS market.

[86] tax and tariff breaks, tax holidays, capital allowances, depreciation allowances, location incentives, favourable corporate tax rates, tax exemptions for some activities, flexible labour policy, unregulated repatriation of profits and cheap asset transfers.

[87] By the end of 2000, the Ghana Free Zones Board (GFZB) had registered 78 companies, of which 52 are operational with more than 6000 employees.

[88] Free Zones incentives: 100% exemption from duties; 100% exemption from tax on income or profits for 10 years; income tax rate shall not exceed 8%; relief from double taxation; no import licensing requirements; 100% ownership of shares by any investor is allowed; no restrictions on total foreign or local ownership; Free zone investments are guaranteed against nationalisation and expropriation.

Zones Board (GFZB)[89] encourages investors to produce value-added products and assists them in attaining the ECOWAS Trade Liberalisation Scheme, ensuring effective market penetration in ECOWAS countries [90];

- The *Central Region Development Commission*, for example, is one of Ghana's first regional development agencies, established to promote investments in the country's central region, in particular, tourism, fisheries, and agro-based industries as well as non-traditional exports of these industries.

The above initiatives are aimed at making Ghana the trade and investment hub within the ECOWAS region. In 1999 the Export Development and Investment Fund was set up to provide financial resources for the development and promotion of exports.

4.3.3. Bilateral, regional and multilateral agreements

Ghana is a founding member of ECOWAS and is an active participant in the ACP Coutenou Agreement. It has various bilateral agreements, the most important of which are accords with the USA, UK and Germany.

4.3.4. FDI Targets

Ghana's effort to accelerate growth and reduce poverty is to be spearheaded by the private sector[91] as the *"main agent for wealth creation"* in the Ghanaian economy in order to:

- Diversify the economy to reduce vulnerability to volatile global commodity prices;
- Increase employment, while raising skill levels;
- Reduce debt while combating poverty within the framework of the Highly Indebted Poor Countries (HIPC) initiative;
- Reduce reliance on foreign donor assistance through stimulating endogenous growth;
- Decrease and control inflation, also by developing domestic/regional energy sources to reduce dependence on imported oil.

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[89] The Government limits itself to facilitating, regulating and monitoring the activities of the zone developers/operators and enterprises.
[90] Budget 2001, presented 9 March 2001 by Minister of Finance Yaw Osafo-Marfo.
[91] An indication of the pro-business approach (Budget 2001) is the appointment of a *Minister of State for Private Sector Development* to be responsible for: pursuit of transparent policies; elimination of bureaucratic impediments to both domestic and foreign investors; creation of the necessary framework for the protection of property rights and business contracts; retraining and redirection of labour to productive activities; and establishment of a positive partnership between Government and private sector in order to increase business activity in the economy.

4.3.5. Barriers to FDI

From an institutional perspective, few barriers to FDI exist in Ghana, while there are the usual risks of uncertainty, poor return etc. and there is growing concern about corruption. Mining and petroleum sector investment projects must be approved and licensed by the Minerals Commission and the Ghana National Petroleum Corporation, respectively, and are subject to environmental regulations. Enterprises with foreign participation must register their companies with the GIPC. Outside of mining, fishing and forestry, FDI in Ghana is no longer screened, only monitored by the GIPC. Only very few minor activities are excluded for foreign firms. Foreign investors are obliged to have minimum capital levels of US$10,000 for joint ventures (the most common form of FDI) and US$50,000 for wholly foreign-owned ventures, unless they engage solely in exporting Ghanaian-produced products.

4.3.6. Impact of FDI on the development of the domestic economy

It is difficult to measure the impact of FDI on the economy in general, because the impact varies significantly by sector and industry. The greatest recent impact has been in services and manufacturing [92] as well as mining where the presence of foreign firms is high. Since the 1980s, more than half of FDI in Ghana has been aimed towards resource-based activities [93], though this has changed recently.

Between September 1994 and December 2000, in terms of number of projects, the largest shares of new investment were in services (26.8%) and manufacturing (25.8%), yet in terms of value services account for more than half (55.6%) [94], indicating some success in efforts to diversify the economy away from primary products. During this period the GIPC registered 1,192 projects at a value of US$1.62 billion, of which 782 (65.6%) were joint Ghanaian-foreign owned and 410 (34.4%) wholly foreign owned with US$1.33 billion foreign and US$290.54 million local equity, respectively. Some 63,851 jobs were created for Ghanaians as a result of the above private investment. Investment tended to be concentrated in the greater Accra area; thus the regional impact of foreign investment is quite important. Projects in areas outside of the capital are to be favoured as part of the regional development strategy of the government.

Ghana has been successful in attracting investment from diversified international sources[95] yet, the average annual increase in gross domestic investment in Ghana during 1990-1999 was only 4.2%, which was far less than the rates recorded in other African

[92] including aluminum smelting, cement production and food-processing.
[93] especially gold, aluminum smelting, bauxite, cement.
[94] GIPC, 2001. Summary of Investment Activities from Sept. 1994-Dec. 2000.
[95] After the UK, USA and Germany, companies from China and India actually accounted for more projects than those from other advanced industrialised countries (Korea and Malaysia are other key investors) and South African and Nigerian companies play an important role in the minerals/extraction industry, in so-called "South-South" investment.

ACP countries[96]. However, it is important to note that some of these countries started from an extremely low base, i.e. Ethiopia and Mozambique, showing a dramatic expansion while the actual value may be far lower than investment in Ghana. Investment trends in Ghana have been somewhat erratic: FDI net inflows in 1996 were US$120 million, dropping to US$17 million in 1999 [97]. According to a recent WTO report, policy and economic uncertainties in Ghana have reduced investor confidence.

4.3.7. Conclusions: Challenges for Ghana

In the general context of this study, the main challenge for Ghana will be to stimulate sustainable investment which respects the environment as well as the rights of local people, while at the same time reduces poverty by providing employment, raising skills and contributing to the development of the local economy. The poverty reduction efforts have been inextricably linked to debt reduction in the HIPC framework.

Ghana is generally regarded as a successful case of investment; yet, Ghana remains a low income country and is extremely vulnerable to world market price fluctuations. It can be argued that there could be some improvements to not just promote investment but sustainable development, which are sometimes at odds with each other (particularly in mining). There has been growing competition with other African countries for investment, particularly that which is not strictly linked to site-dependent natural / mineral resources endowment. Ghana has the advantage of a large natural resources base, but also risks destroying some of its greatest natural assets if mining is not undertaken in an environmentally and socially responsible manner. Growing community activism has required foreign investors to change some of their strategies and take social and environmental issues into consideration. Ghana must find a sustainable balance between the need for growth to combat debt and poverty and restraint in order to preserve the natural environment and traditional lifestyles.

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[96] Angola (12.9%), Côte d'Ivoire (17.6%), Ethiopia (13.4%), Mozambique (13.1%), Togo (11.6%), and Zambia (11.3%). World Bank, *World Development Report 2000/2001*, September 2001. World Development Indicators.

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5. CONCLUSIONS: POLICY RECOMMENDATIONS

FDI has tremendous potential to improve opportunities for developing countries to take advantage of globalisation trends by improving the quality of factors of production and establishing linkages with other markets. However, this process is hampered by a multitude of structural economic and institutional impediments and regulatory deficiencies, both domestically (in the host countries) and at the international level. The increasing marginalisation of the LDCs reflects the failure of poverty reduction strategies in past decades, as well as the limited contribution of FDI to the development process: the shift in the strategic approach to poverty reduction in recent years has not yet been translated into measurable effects, because of the severity and complexity of the situation in many of the countries.

The close relationship between a country's capacity to attract and absorb investment, domestic economic and social conditions and institutional capacity confirms that FDI *per se* cannot bring about the expected multiplier effects in the host country economy in the absence of suitable economic framework or a sufficiently effective regulatory framework, facilitating further positive linkages with the local economy. On the other hand, the investment strategies of lead by TNCs, are not always concerned with the upgrading of local resources and improving conditions in the host countries: the problem of international arbitration is still an imperative open issue.

In this respect there are two critical issues that reflect the dramatic changes characterising the current phase of globalisation:

1. The increasing *gap* between the pace of globalisation of investments and flows of information, technology and goods and the capacity of institutions and international organisations to regulate these flows requires a strategic rethinking of approach: the difficulties in implementing and enforcing standard rules to regulate and govern the complexity of material (capital and goods) and intangible flows (information, knowledge, skill, management capacity, etc.) make it far more difficult for developing countries that have little bargaining power to improve their marginal role in global economic integration. The need for international organisations to play an innovative and more powerful regulatory role is one of the main challenges for the future;

2. The necessity for *more co-ordinated and effective delivery of aid and technical assistance* by the international organisations, in cooperation with the wealthiest developed countries in order to offset their relative decline in development expenditures. Overlapping, competing and sometime diverging policy approaches have narrowed the overall effectiveness of aid provision from the different sources. The recent trend toward more co-ordinated and common initiatives marks a positive change that requires further progress in order to maximise the aid efforts and gaining better value for the money spent.

The analysis developed in this report emphasises that there is a clear need to address the issue of *public policy effectiveness* and *linkages between the different policy fields*.

The following issues need to be examined in greater detail:

- Despite the failure of the MAI to establish international rules for FDI, such an effort needs to be once again undertaken, though this time with more emphasis on consensus-building between the international organisations and involving representatives from the developing countries. There is much room for initiatives at the international level which have not received enough attention and commitment from the major players;

- The issues related to the *"social responsibility"* of the TNCs comprise an integral part of this package. An *international code of conduct* regarding rules *imposed on TNCs* (and other investors) needs to establish coherent linkages between the latter and the *Multilateral Agreements*: specific problems related to investment activities in the Developing Countries need to be addressed, while favouring the progressive consolidation of stricter legal regulations. Voluntary (non-binding) rules are not sufficient in many cases, especially when there is not willingness on the part of the TNC to support socially responsible investment activities in the host country;

- The *level of trade liberalisation* in the developed countries, while having improved considerably over recent years, is not yet sufficient to allow developing countries to significantly improve their market access: the dramatic decline of their exports over the past few years confirms this unfavourable trend. The implementation of WTO rules still needs to be fully and more broadly enforced. At the same time, in order to overcome non-tariff trade barriers, there is a clear requirement to improve the skill capacity of developing country public administrations in order to put into place effective *quality standard monitoring and technical certifications capacities* to apply the rigorous consumer safety and phyto-sanitary standards on the basis of developed countries consumer market principles: this could also improve export capacity and competitiveness in accessing these markets;

- Improving the *transfer of information technology* (IT), with particular attention to social and cultural brackets of the population that could become potential small business operators (like young people or women), can assist in the upgrading of the business environment in general, reinforcing the capacity to attract FDI. The international organisations need to address the still substantial obstacles to more diffused utilisation of IT, also because the investment costs for such technologies are relatively low in comparison with the benefits that could be gained without requiring high skills. However, basic infrastructure development would have to be undertaken; for example, for Internet use the telephone system would need to be improved, especially in remote rural areas;

- There is a necessity to promote *diversification of FDI activities*, taking into consideration the specificities of the economic and social background of the host countries: while targeted campaigns to encourage investment in particular sectors and activities are present in the investment attraction efforts of some of the more advanced developing countries, an approach focusing on the " *development*

obligations" of the TNCs has been called too optimistic. Yet channelling the investment activities of the TNCs into new areas that would help the improve host countries' capacities to diversify their economies would support greater development efforts. It is necessary to support the application of a *broader investment strategy* by TNCs in order to establish linkages with the host country to facilitate the *creation of SMEs* associated with the main sector of foreign investment, thus favouring the emergence of potential *backward linkages* with local entrepreneurs as subcontractors. By introducing more *value-added activities,* without requiring very high skills and utilising "development friendly technology", could help upgrade the level of knowledge and ability of local labour resources, in turn boosting new private sector development in the manufacturing as well as services;

- It could also be desirable to *promote more diversification in the types of foreign investors from developed countries*: in particular, it could be beneficial to encourage companies other than TNCs, in particular *SMEs,* to invest in developing countries and engage in more development-favourable and locally based investments that are better adapted to the conditions there. At the same time, the higher level of *country and commercial risk* for such investors needs to be addressed, because of the lower capacity of the SMEs to assume such risks by themselves. In this perspective, joint initiatives could be developed to work out more tailored schemes for FDI promotion together with those ACP governments that are politically more stable and co-operative;

- As articulated within the Cotonou Agreement, the importance of the *regional groupings* could be enhanced. Technical assistance focused on improving the capacities of their inter-regional regulatory and trade systems could be of great significance and have a very positive impact in lowering those barriers to the flow of goods and investments that still hinder closer economic integration. Improving the capacity to enforce trade and investment regulations would also facilitate the further development of the relationship between the EU and the ACP countries, creating better conditions and mutual understanding for future *economic agreements*.

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STATISTICAL ANNEXES

TABLE 1

Financial Indicators*

	GNI per capita	GDP	GDP per capita	Agriculture	Gross capital formulation	Private fixed invest.	Military expenditures	High tech. exports	Total external debt	Foreign direct invest.
	PPP $ 2000	Av. ann. real growth % 1999-00	Av. ann. real growth % 1999-00	% of GDP 2000	% of GDP 2000	% of GDFI 1998	% of GNI 1997	% of manufact. exports 1999	$ millions 1999	% of GDP 1999
East Asia & Pacific	4,120	7.4	6.5	15	31	50.2	2.5	31	674,693	3.0
Europe & Central Asia	6,620	6.4	6.3	*10*	19	--	4.0	10	486,059	3.1
Latin America & Caribbean	7,030	3.9	2.3	8	21	*79.8*	1.8	14	812,763	5.1
Middle East & North Africa	5,170	*2.3*	*0.3*	*14*	*21*	--	7.1	*1*	206,163	0.2
South Asia	2,260	5.8	3.8	27	23	71.8	3.1	*4*	164,600	0.5
Sub-Saharan Africa	1,560	2.9	0.5	*15*	17	--	2.3	9	216,359	2.6

*** Note**: Figures in italics are for years or periods other than those specified.

Source: World Bank, 2001, *World Development Indicator*, Washington.

TABLE 2

Social Indicators

	Population	Life ex-pectancy	Infant mortality	Youth illiteracy rate		Prevalence of child malnutrition		Rural population	Freshwater resources
	average ann. growth % 1980-2000	at birth years 1999	per 1,000 live births 1999	Male % ages 15-24 2000	Female % ages 15-24 2000	Weight for age % under 5 1993-99	Height for age % under 5 1993-99	% of total 2000	cubic meters per capita 1999
East Asia & Pacific	1.4	69	35	2	4	13	23	65	
Europe & Central Asia	0.5	69	21	1	2	--	--	33	12,797
Latin America & Caribbean	1.8	70	30	6	6	9	16	25	27,934
Middle East & North Africa	2.6	68	44	12	23	--	--	41	1,147
South Asia	2.0	63	74	23	40	47	43	72	2,854
Sub-Saharan Africa	2.7	47	92	18	26	--	--	66	8,248

Source: World Bank, 2001, *World Development Indicators,* Washington.

Table 3

Population living below $1.08 a day

1993 Purchasing Power Parity

	Poverty rate (% below $1.08)					Number of poor (1,000,000)				
	1987	**1990**	**1993**	**1996**	**1998**	**1997**	**1990**	**1993**	**1996**	**1998**
East Asia and Pacific	26.60	27.58	25.24	14.93	15.32	415.13	452.45	431.91	265.13	278.32
Excluding China	22.91	15.04	12.37	8.05	9.61	109.22	75.99	65.96	45.17	55.59
East Europe and Central Asia	0.24	1.56	3.95	5.12	5.14	1.07	7.14	18.26	23.82	23.98
Latin America and Caribbean	15.33	16.80	15.31	15.63	15.57	63.66	73.76	70.79	75.99	78.16
Middle East and **North Africa**	11.53	9.28	8.41	7.81	7.32	24.99	21.99	21.54	21.35	20.85
South Asia	44.94	44.01	42.39	42.26	39.99	474.41	495.11	505.08	531.65	522.00
Sub-Saharan Africa	46.61	47.67	49.68	48.53	46.30	217.22	242.31	273.29	288.97	290.87
Total	28.69	29.32	28.50	24.86	24.27	1196.48	1292.74	1320.88	1206.92	1214.18
Excluding China	29.56	29.34	28.47	28.15	27.30	890.57	916.29	954.92	986.95	991.46

Source: World Bank, 2001, Washington.

Table 4

Summary Debt Service for 23 HIPCs that Reached Decision Points by end 2000

(In million US dollars, unless otherwise indicated)

	1998	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
1. AFRICAN COUNTRIES								
Debt service paid[1]	1,998	1,849	967					
Total debt service due after enhanced HIPC Initiative relief[2]			697	1,315	1,298	1,334	1,555	1,501
Ratio of debt service to exports (in percent)[3]	16.3	14.9	12.6	9.0	7.9	7.5	8.1	7.0
Ratio of debt service to government revenue (in percent)[3]	25.1	22.0	18.3	12.8	11.3	10.5	11.0	9.7
Ratio of debt service to GDP (in percent)[3]	3.4	3.2	2.8	2.0	1.8	1.7	1.9	1.6
2. LATIN AMERICAN COUNTRIES								
Debt service paid[1]	1,030	670	126					
Total debt service due after enhanced HIPC Initiative relief[2]			627	523	670	701	646	693
Ratio of debt service to exports (in percent)[3]	19.2	13.2	13.2	8.2	9.4	8.8	7.4	7.2
Ratio of debt service to government revenue (in percent)[3]	27.8	17.8	19.2	12.2	14.4	13.7	11.6	11.3
Ratio of debt service to GDP (in percent)[3]	6.2	4.0	4.4	2.9	3.5	3.4	3.0	3.0
Total (23 countries)								
Debt service paid[1]	3,027	2,518	1,093					
Debt service due after enhanced HIPC Initiative relief[2]			1,323	1,838	1,968	2.035	2,201	2,194
3. WEIGHTED AVERAGE (23 countries)[4]								
Debt service/exports (in percent)	17.2	14.4	12.1	8.7	8.4	7.9	7.9	7.1
Ratio of debt service to government revenue (in percent)	25.9	20.7	17.6	12.6	12.2	11.4	11.2	10.1
Debt service/GDP (in percent)	4.0	3.3	3.0	2.2	2.2	2.1	2.1	1.9

Sources: HIPC country documents and World Bank and IMF staff estimates.

[1] The debt service figures for 2000 include only those countries that did not reach their decision point until late in 2000 or later. The figures are largely pre-HIPC relief, as these countries received little or no HIPC assistance during the year. The full impact of relief for these countries will not be felt until 2001 and thereafter.
[2] The debt service figures for 2000 include only those countries that reach their decision points early that year.
[3] Weighted averages.
[4] The averages for 2000 are largely pre-HIPC as 12 of the 23 countries did not reach their decision point until December 2000 or later.

Note. Debt service figures for 1998 and 1999 reflect debt relief already provided to Bolivia, Guyana, Mozambique and Uganda under the original framework.
The countries which benefited from HIPC are: Benin, Bolivia, Burkina Faso, Cameroon, Chad, The Gambia, Guinea, Guinea-Bissau, Guyana, Honduras, Madagascar, Malawi, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, São Tomé and Principe, Senegal, Tanzania, Uganda, Zambia.

Table 5

FDI inflows, by region, 1988-2001

(Billions of dollars)

Region	1998	1999	2000	2001[a]
World	693	1 075	1 271	760
Developed countries	483	830	1 005	510
Developing countries [b]	188	222	240	225
Africa [c]	8	9	8	10
Latin America and the Caribbean	83	110	86	80
Asia and the Pacific	96	100	144	125
South, East and South-East Asia	86	96	137	120
Central and Eastern Europe	21	23	25	25
Including the countries in the former Yugoslavia	22	25	27	27

Source: UNCTAD, FDI/TNC database.

[a] Preliminary estimates, made on 3 September 2001, on the basis of 51 countries that accounted for more than 99% of FDI inflows in 2000.
[b] Including the countries in the former Yugoslavia.
[c] If South Africa is included, the figures are 8 in 1988, 10 in 200 and 11 in 2001.

Table 6

Inward and outward FDI stocks as a percentage of gross domestic product, by region and economy, 1980, 1985, 1990, 1995 and 1999 (Percentage)

Region/economy	1980	1985	1990	1995	1999
Developing countries and economies					
inward	10.2	14.1	13.4	15.6	28.0
outward	*0.9*	*1.6*	*2.6*	*4.8*	*10.1*
Africa					
inward	4.6	7.4	11.1	18.2	21.0
outward	*0.4*	*2.7*	*4.4*	*5.6*	*4.9*
North-Africa					
inward	4.1	5.8	8.2	13.6	13.7
outward	*0.3*	*0.4*	*0.6*	*0.6*	*1.0*
Other-Africa					
inward	4.9	8.7	14.3	23.5	29.9
outward	*0.5*	*5.4*	*10.4*	*12.8*	*10.4*
Latin America and the Caribbean					
inward	6.5	10.9	10.3	11.8	25.6
outward	*1.3*	*2.0*	*1.8*	*2.9*	*4.9*
Other Latin America and the Caribbean					
inward	7.2	14.5	14.6	22.6	31.2
outward	*0.8*	*2.4*	*3.0*	*6.6*	*7.5*
The Pacific					
inward	22.4	24.3	28.8	25.1	35.0
outward	*0.3*	*1.0*	*1.9*	*1.8*	*5.1*

Source: UNCTAD, *World Investment Report 2001.*

Table 7

Rates of return on United States FDI in Africa and selected regions 1983-1997[a]

(per cent)

Region/sector	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997 b
Africa[c]	17.7	23.7	17.3	5.6	15.5	13.9	17.4	24.2	30.6	28.4	25.8	24.6	35.3	34.2	25.3
Primary [d]	19.3	27.1	19.6	4.9	12.8	10.2	13.0	22.8	35.4	29.1	26.1	23.9	34.2	36.9	
Secondary [d]	13.9	13.6	8.8	13.8	19.0	24.0	15.4	20.4	16.0	18.9	30.5	30.0	42.8	21.3	
Tertiary [d]	11.9	7.1	3.4	19.5	20.6	8.7		23.8		22.2	23.5	21.7	21.6	23.1	
Other industr. [d,e]	2.0	7.0	16.9	21.5	36.6	41.7		48.0	28.4	40.8	13.5	44.1	35.0	17.4	
Asia & Pacific	27.6	26.1	18.1	13.0	20.3	22.4	23.3	27.6	23.8	22.6	20.7	18.4	20.2	19.3	16.2
Latin America & Caribbean	7.0	9.9	9.5	10.3	9.5	14.2	15.7	13.0	12.1	14.3	14.9	15.3	13.1	12.8	12.5
Developing countries	14.9	17.3	13.4	10.9	13.2	16.5	17.8	17.2	15.9	17.2	16.9	16.5	15.8	15.3	14.0
All countries	13.0	14.3	12.6	12.2	13.4	15.5	14.8	14.3	11.6	10.4	11.1	11.7	13.3	12.5	12.3

Source: UNCTAD 1998b, based on United States Department of Commerce, various issues.

[a] The rate of return is calculated as the net income of United States foreign affiliates in a given year divided by the average of beginning of year and end of year FDI stock. The FDI stock data are valued at historical costs, resulting in an under valuation of investment undertaken recently as compared to investments of an older date. This could create a bias towards higher rates of return for Africa in relation to other regions, under the assumption that a relatively higher share of FDI stocks in Africa than in other regions would be of a relatively old date.

[b] The stock data for 1997 used in the calculation are estimates by the United States Department of Commerce.

[c] Not including South Africa.

[d] Including South Africa.

[e] Includes agriculture, forestry and fishing, mining, construction, transportation and communication as well as public utilities.

Table 8

Cross-border M&As: sales and purchases, by region, 1990-1999

(Billions of dollars)

Region/Economy	Sales					Purchases				
	1990	1995	1997	1998	1999	1990	1995	1997	1998	1999
Developed countries	**134.2**	**164.6**	**234.7**	**445.1**	**644.6**	**143.2**	**173.7**	**272.0**	**511.4**	**677.3**
of which:										
European Union	62.1	75.1	114.6	187.9	344.5	86.5	81.4	142.1	284.4	497.7
United States	54.7	53.2	81.7	209.5	233.0	27.6	57.3	80.9	137.4	112.4
Japan	0.1	0.5	3.1	4.0	15.9	14.0	3.9	2.7	1.3	9.8
Developing countries	**61.1**	**15.9**	**64.3**	**80.7**	**63.4**	**7.0**	**12.8**	**32.4**	**19.2**	**41.2**
of which:										
Africa	0.5	0.2	1.7	0.7	0.6	-	0.1	-	0.2	0.4
Latin America & Caribbean	11.5	8.6	41.1	63.9	37.2	1.6	4.0	10.7	12.6	24.9
Europe	.	.	-	-	0.3	-	-	.	-	-
Asia	4.1	6.9	21.3	16.1	25.3	5.4	8.8	21.7	6.4	15.9
Pacific	-	0.1	0.3	.	0.1	-	-	-	-	-
Central & Eastern Europe [a]	**0.3**	**6.0**	**5.8**	**5.1**	**10.3**	**-**	**0.1**	**0.3**	**1.0**	**1.6**
World [b]	**150.6**	**186.6**	**304.8**	**531.6**	**720.1**	**150.6**	**186.6**	**304.8**	**531.6**	**720.1**

Source: UNCTAD, *World Investment Report 2000: Cross-border Mergers and Acquisitions and Development*

[a] Includes the countries of the former Yugoslavia.
[b] Includes amounts that cannot be allocated by region.

Table 9

Sectoral composition of FDI stock in Africa of selected major home countries

1989/1990 and 1995/1996/1997 (per cent)

	France		Germany		United Kingdom		United States	
	1990	1995	1990	1996	1989	1997	1990	1997
Primary	39	52	25	16	37	37	57	58
Secondary	43	27	20	20	37	37	15	14
Tertiary	17	17	55	64	26	26	23	18
Unallocated	1	4	-	-	-	-	5	10

Source: UNCTAD, FDI/TNC database.

Note: Unallocated includes holdings.