Briefing Paper 3

FOREIGN DIRECT INVESTMENT

The most rapidly increasing resource flow to least developed countries over the past decade has been foreign direct investment (FDI), which rose from less than $5 billion in 2000 to about $33 billion in 2008, before declining to $28 billion in 2009 under the impact of the global recession.

Dynamism in volume of FDI is matched by a rapid shift in its countries of origin.

Traditionally, the great bulk of outside investment has come from developed countries. Now, 60 per cent of FDI flows emanate from developing and transition countries (including from sovereign wealth funds), according to the *World Investment Report 2010* of the UN Conference on Trade and Development (UNCTAD).

In the Democratic Republic of the Congo, Malawi and Lesotho, for instance, about half of inward FDI comes from their neighbour South Africa. The report of the UN Secretary-General on South-South cooperation estimates that 40 per cent of FDI from countries of the South goes to least developed countries.

But the share of global FDI going to LDCs nevertheless remains below 2 per cent. Furthermore, investment is not evenly spread or of a composition highly beneficial for long-term development – 12 oil- and mineral-exporting nations account for about 76 per cent of total FDI to the 48 least developed countries. (One non-extractive growth area, however, is investment in African telecoms.)

In 2009, for instance, Angola took in more than $13 billion in FDI (down from a $16.5 billion peak in 2008); Sudan, $3 billion; and Equatorial Guinea, $1.6 billion. The drop-off among LDC recipients of FDI after that is rapid, with 32 of the 48 receiving less than $200 million in 2009.

Capital formation in the LDCs currently comes largely from external rather than domestic sources, so boosting FDI is a strategic area for the least developed countries. Disadvantages in attracting investment that need to be overcome include limited market size, weak business environment, shaky infrastructure and a high level of perceived risk.

Positive features are the attraction of investing in export-oriented industries to take advantage of preferential access for LDC products in rich-country markets, and flows of official development assistance, if they are aligned with enhancing the investment environment.

According to a global meeting of finance ministers (Lisbon, 2010), LDC governments need to foster an enabling policy and regulatory framework that will attract FDI. Specifically, ministers said, they should:

- encourage FDI through public-private partnerships in infrastructure, including transport, communication and energy, especially clean or renewable energy;
- increase knowledge transfer and skill development from FDI through vocational education in partnership with foreign enterprises;
- reinforce capacity to negotiate with multilaterals;
- formulate an integrated strategic policy and regulatory framework for FDI in agricultural production, including on infrastructure development, competition, trade and trade facilitation, and R&D;
- with proper safeguards, governments could also promote contract farming between transnational agribusinesses and farmers to enhance farmers' predictable income and productive capacities and allow them to benefit from global value chains.

In order to address concerns related to large-scale land purchases in poor countries, a set of recommended core principles is being developed by FAO, IFAD, UNCTAD and the World Bank. These principles need to be implemented jointly by host and home countries. To ensure food security in host countries as a result of export-oriented FDI in food production, home and host countries could consider output-sharing arrangements.

International support measures including market access and ODA should be designed in a way to encourage FDI in all LDCs in priority sectors, including in labour-intensive manufacturing.

Specifically, ODA to build technical capacity of domestic firms would enable them to partner with foreign investors.

Finance ministers meeting in Lisbon expressed the hope that incentives could be directed toward maximizing the lasting impact of outward investments heading to the LDCs. Thus development partners could adopt investment preference regimes through:

- market access schemes;
- tax exemptions for firms that invest in priority sectors;
- investment and credit-risk guarantees;
- inclusion of productive capacity and infrastructure-related provisions in International Investment Agreements;
- dissemination of information about investment opportunities in LDCs to suitable donor country firms; and
- encouragement of multinationals to disclose corporate information about their investments in LDCs.

Laying fibre-optic cable off the East African coast: More least developed countries will have faster and cheaper communications links with the outside world.
Photo: Reuters/Joseph Okanga

REMITTANCES FROM WORKERS OVERSEAS

Another source of private external financing is the money sent home to least developed countries by migrants living and working abroad. Such remittances have been increasing in volume over the past decade, from $6 billion in 2000 to $23 billion in 2008 and an estimated $24 billion in 2009, according to the World Bank. They represent around 4 per cent of total LDC gross domestic product (GDP). In Lesotho and Samoa, remittances made up more than a quarter of the GDP in 2008 and around one fifth in Nepal and Haiti.

Most remittances are used for personal or family consumption, thus reducing poverty and hunger but not adding much in the way of capital allocation. Nevertheless, to a lesser extent remittances have been used to build small and medium enterprises, and their circulation within LDCs helps to strengthen grassroots mechanisms of the financial sector. Community projects financed through remittances contribute to local infrastructure.

Another important feature of remittances is their resistance to global recessions, as indicated by the fact that their volume held steady and is estimated to have increased over the course of 2009. Reflecting the determination of LDC citizens overseas to support their families even if they have to tap scarce personal savings, this resilience to negative economic trends helps to offset the pro-cyclical pattern of FDI and development aid, which tend to increase during booms and shrink during busts.

One area of strategic opportunity for improving the benefits of remittances is to work out ways to reduce the often-high transaction costs associated with transmitting funds across borders and to develop schemes and incentives to channel them towards more productive investment.

Shopping mall in Kampala, Uganda: More foreign investors are seeking to tap into growing incomes of LDC consumers. | Photo: Panos/Mikkel Ostergaard

FDI INFLOW TO LDCs BY REGION (billions of $US)

	2008	2009
AFRICA	27.9	25.6
LATIN AMERICA & CARIBBEAN	0.0	0.0
ASIA	4.3	2.1
OCEANIA	0.1	0.2
TOTAL	32.4	28.0

Source: UNCTAD, WIR 2010

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