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Foreign Direct Investment in Africa

Policies Also Matter

Jacques Morisset

A few Sub-Saharan countries, by improving their business environment, have begun to attract more substantial foreign direct investment than other African countries with bigger domestic markets and greater natural resources. Like Ireland and Singapore, perhaps they can become competitive internationally and attract sustainable foreign direct investment.

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Summary findings

Africa has not succeeded in attracting much foreign direct investment in the past few decades. When countries did attract multinational companies, it was principally because of their (abundant) natural resources and the size of their domestic market. Angola, Côte d'Ivoire, Nigeria, and South Africa have traditionally been the main recipients of foreign direct investment in Sub-Saharan Africa.

But Morisset shows that a few Sub-Saharan countries have generated interest among international investors by improving their business environment. In the 1990s, Mali, Mozambique, Namibia, and Senegal attracted substantial foreign direct investment—more so than countries with bigger domestic markets (Cameroon, Republic of Congo, and Kenya) and greater natural resources (Republic of Congo and Zimbabwe).

Mali and Mozambique, which improved their business climate spectacularly in the 1990s, did so with a few strategic actions: liberalizing trade, launching an attractive privatization program, modernizing mining and investment codes, adopting international agreements on foreign direct investment, developing a few priority projects that had multiplier effects on other investment projects, and mounting an image-building effort in which political figures such as the nation's president participated.

These actions are similar to those associated with the success of other small countries with limited natural resources, such as Ireland and Singapore about 20 years ago.

This paper—a product of the Foreign Investment Advisory Service, International Finance Corporation—is part of a larger effort to understand foreign direct investment flows in developing countries. Copies of the paper are available free from the World Bank, 1818 H Street NW, Washington, DC 20433. Please contact Nessa Busjeet, room I9-107, telephone 202-473-3997, fax 202-974-4303, email address nbusjeet@ifc.org. Policy Research Working Papers are also posted on the Web at www.worldbank.org/research/workingpapers. The author may be contacted at jmorisset@ifc.org. November 2000. (20 pages)

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Introduction

For many observers, the capacity of African countries to attract foreign direct investment (FDI) is principally determined by their natural resources and the size of their local markets. Over the years, Nigeria and Angola have been two of the most successful countries because of their comparative location advantage in oil despite their unstable political and economic environments.

The apparent lack of interest of transnational corporations (TNCs) in African countries that have attempted to implement policy reforms has also contributed to support this argument. The balkanization of African countries is frequently used as an argument that this continent has been much less favoured than Asia and Latin America over the past decade. It has been argued that the reforms in many African countries have been incomplete and thus have not fully convinced foreign investors to develop activities that are not dependent on natural resources and aimed at regional and global markets. True, it takes time for a country to modify its image, especially when the State has a long tradition of policy intervention, and when the reforms have been mostly symbolic with the adoption of new texts that have not yet been translated into actions.

This note will identify which African countries have been able to attract FDI by improving their business climate. These countries show that pro-active policies and reform-oriented Governments can generate FDI interest. This conclusion does not differ from the one reached for countries such as Singapore or Ireland. It simply makes the point that African countries can also be successful in attracting FDI that is not based on natural resources or aimed at the local market, but rather at regional and global markets, by implementing policy reforms. An econometric analysis of 29 African countries and a detailed review of two successful ones – Mali and Mozambique – will illustrate which policy factors have played a significant role in the improvement of their business climate – at least in the views of foreign investors.

Why? Determinants of FDI in Africa

Although there has been a considerable number of analytical and empirical studies on FDI inflows,[1] there has been a limited consensus on which factors play an unambiguous role in explaining the location decision of TNCs. It is generally accepted that market size and access to natural resources are crucial determinants in their decision processes.

Not surprisingly, the African countries that have been able to attract most FDI have been those with the largest tangible assets such as natural and mineral resources as well as large domestic markets. About 65 per cent of total FDI inflows to Africa concentrated in South Africa, Nigeria, and Cote d'Ivoire in 1996/1997, which also accounted for about two-third of the sub-continent's GDP during the same period (table 1). The role of market size can be further evidenced by the almost perfect positive correlation between FDI inflows and GDP for a group of 29 African countries during 1996 and 1997 (the correlation coefficient equals 0.99)[2].

The role of natural resources in the location decision of TNCs is apparent through the sectoral allocation of FDI inflows within the region. Traditionally, about 60 per cent of FDI in Africa is allocated to oil and natural resources (UNCTAD, 1999). This is corroborated by the coefficient correlation between FDI inflows and the total value of natural resources in each country,[3] which appears close to unity (i.e. 0.94) for the group of 29 African countries during 1996-1997. The Africa region possesses not only large reserves of oil, gold, diamonds and copper but also more than half of the world's cobalt and manganese, one third of bauxite and more than 80 per cent of chromium and platinum. The sub-continent is also among the main exporters of agricultural products such as cocoa, coffee and sugar.

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[1] See for example, Wheeler and Mody (1992); Singh and Jun (1995); UNCTAD (1998).

[2] The link between FDI inflows and size could be further explored, as, for example, one may argue that there may exist a non-linear relationship between these two variables. This goes, however, beyond the scope of this note.

[3] The total value of natural resources in each country is estimated as the sum of the primary and the secondary sectors, minus manufacturing. Source: World Bank's *World Development Report (1999)*.

The strong reliance of African countries on their natural resources and market size has been well evidenced by many studies.[4] It might be more pertinent to look at which countries have been most successful in attracting FDI over the past few years, when they could not rely on the natural resources and the size of their domestic market. To do so, we propose to normalize the value of total FDI inflows by GDP and the total value of natural resources in each country. For simplicity, we label this indicator as the business climate for FDI (FDIBC):

$$FDIBC_i = FDI_i / (GDP_i * NR_i)^a \qquad (1)$$

where FDI is defined as the FDI inflows in country i, GDP as the gross domestic product and NR the value of natural resources (all of them expressed in dollars). Equation (1) assumes that the elasticities of FDI inflows to changes in GDP and natural resources are both equal to unity (a = 1), which seem consistent with the estimated elasticities that will be reported later in the paper for the group of African countries surveyed in this note.[5]

[4] See for example, Pigato (2000) for a review.

[5] The assumption that both elasticities equal unity is valid for the group of African countries covered in this note. However, if the sample is widened to include industrial countries for example, this assumption does not hold because of the large differences in GDP level between countries (for example, United States and Burundi).

Table 1. FDI inflows and GDP: ranking of 29 African countries, average 1996-1997
(Millions of dollars)

	Net FDI Inflows	GDP
South Africa	2313.5	129094
Nigeria	1566.0	36540
Cote d'Ivoire	305.1	10251
Angola	265.5	7396
Tanzania	154.0	6707
Uganda	148.0	6555
Namibia	109.9	3453
Ghana	101.3	6762
Senegal	92.2	4542
Mozambique	68.3	1944
Zimbabwe	66.5	8512
Zambia	64.0	4051
Mali	61.6	2532
Mauritius	46.7	4151
Cameroon	40.0	9115
Benin	31.5	2137
Guinea	20.6	3998
Chad	16.5	1603
Kenya	16.2	9899
Madagascar	12.1	3552
Congo, Republic	8.5	2298
Central African Republic	5.5	954
Ethiopia	5.0	6330
Rwanda	2.4	1771
Congo, Democratic Rep. Of.	1.5	6904
Malawi	1.5	2424
Burundi	1.0	1137
Niger	1.0	1858
Sierra Leone	1.0	940

Source: **World Development Report, World Bank (1999).**

Our indicator captures the attraction of African countries for FDI when they can rely on everything except for their natural resources and market size. Therefore, it reflects not only policy and political variables but also a series of structural factors such as infrastructure, transport costs and human capital. By indicating the attraction of the FDI business climate for each country, it complements the data collected in investors' surveys and cross-country ranking such as *The Africa Competitiveness Report* published by the World Economic Forum. One has to keep in mind, however, that our indicator reflects existing rather than potential data/information and, thus, might be a poor predicator of future FDI flows.

Table 2. Business Climate for FDI: ranking of 29 African countries, average 1995-1997

Country	FDI/business climate [a]	ICRG political risk [b]	Institutional Investor [c]
Namibia	1	1	NA
Mali	2	12	13
Mozambique	3	11	18
Zambia	4	4	14
Chad	5	NA	NA
Senegal	6	13	6
Angola	7	18	20
Benin	8	NA	12
Mauritius	9	NA	1
Cote d'Ivoire	10	8	8
Tanzania	11	5	10
Uganda	12	15	11
Central African Republic	13	NA	NA
Ghana	14	7	4
Madagascar	15	9	NA
Burundi	16	NA	NA
Rwanda	17	NA	NA
Zimbabwe	18	4	3
Congo, Rep.	19	14	19
Nigeria	20	17	15
Niger	21	20	NA
Guinea	22	19	17
Malawi	23	6	7
Cameroon	24	16	9
Kenya	25	5	5
South Africa	26	2	2
Ethiopia	27	10	15
Sierra Leone	28	21	22
Congo, Dem. Rep.	29	22	21

Sources: Author's own calculations; Pigato (1999).
[a] The business climate index is defined as net FDI inflows normalized by GDP and the total value of natural resources in each host country.
[b] Political risk rating based on the opinion of banks, TNCs and other institutional investors indicating corruption, political and judicial institutions.
[c] Institutional Investor rating measures a country's creditworthiness, which is mostly determined by economic and financial variables.

The ranking of 29 African countries according to the indicator proposed above is presented in table 2 (first column). In 1995-1997, the most attractive country was Namibia, followed by Mali, Mozambique, Zambia, Chad and Senegal.[6] The least attractive were Congo, Sierra Leone and Ethiopia. Preliminary findings for 1998 indicate

[6] The good ranking of Chad and Zambia reflects that the first country offers great oil reserves (not reflected in our indicator of natural resources) that have attracted companies interested to explore those

that there have not been many changes in the ranking, with Mozambique and Namibia still on the top of the list.[7] A rapid comparison across regions reveals that Singapore had a FDI business indicator index twice as high as the best African country in 1995/1997. However, Ireland and Hungary were ranked about the same level as Senegal and Mauritius. This result may appear surprising at first sight, but one can observe that the flows of FDI were about the same in Senegal and Ireland, when compare to their respective GDP in 1997 (about 3.8 per cent) and Ireland has, in dollars, more natural resources than Senegal. It may also reveal some of the limits of our indicator when the differences in GDP are too big across countries – the assumption that FDI is perfectly elastic to changes in GDP might not be robust across region or countries with large differences in GDP levels.

Our ranking can be compared with those obtained in some well known surveys such as the International Country Risk Guide (ICRG) and the Institutional Investors (II) ratings that are reported in the second and third columns of table 2.[8] If the ranking appears quite similar for a few countries,[9] there exist significant differences both at the top and bottom of the table. While South Africa, Zimbabwe, Kenya and Malawi appear in the bottom half of our ranking, they are on the top of the list for the two other indicators. On the other hand, Mali and Mozambique have not been ranked very high by the ICRG and II indexes but are among the most attractive countries according to our indicator.[10]

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possibilities; Zambia has followed a relatively aggressive privatization programme and liberalization policy.

[7] The 1998 ranking is incomplete because the data on FDI inflows are still missing for a few countries.

[8] Unfortunately, the Competitiveness Indicator developed by the World Economic Forum is not available for most of the countries covered in this note. However, Namibia and Mauritius were also well ranked in their 1998 ranking, but South Africa was perceived as much more competitive, while Mozambique much less than reported in this note.

[9] For example, Namibia has been traditionally perceived as a secure country, with satisfactory macroeconomic indicators, a good and reliable judiciary system and access to the large South African market. Similarly, the weak performance of Sierra Leone and Congo has been well publicized with their unstable political climate and multiple economic problems.

[10] In fact, the coefficient correlation between our indicator and the ICRG and II indexes is negative for the period 1996-1997 (see more details in the next section).

In our opinion, these differences can be explained the by more global concept captured by our indicator, which aims at reflecting the FDI that cannot be explained by the size of the local market and the availability of natural resources. As mentioned earlier, it reflects not only the policy and political environment in a host country but also a series of factors such as the geographical location, infrastructure and the stock of human capital. The ICRG and II indexes capture only two of these multiple elements: the political and financial risks in each country. Another major difference is that these indexes are built with investors' surveys, mainly international banks, and thus are more subjective and forward-looking than our indicator that is constructed by using actual FDI flows and economic data. These differences can be illustrated by the cases of Zimbabwe and South Africa. Although Zimbabwe appears to be a country with low political (fourth out of 24 countries) and financial (third) risks, the fact of the matter is that most foreign investors have been reluctant to invest there. Their prudence may be explained by the weak growth performance over the past few years and numerous barriers against FDI, especially when Zimbabwe is compared to market-oriented neighbours such as Zambia, Uganda and Mozambique. Those obstacles are not captured by the ICRG or II index. The South African economy has benefited from large inflows of FDI in the recent years, but they have been mainly due to the privatization process, the return of companies based in neighbouring countries during the apartheid period and the interest of investors in the large domestic market (about three times greater than the second largest African country, i.e. Nigeria). Those factors are not related directly to the business climate, which remains quite problematic. The trade liberalization process remains timid with the exclusion of some important industries and relatively long transition periods. The economic growth performance in recent years has proved to be too modest to convince foreign investors, which is reflected in our indicator but not clearly in the ICRG or II index.

It might be useful to examine the variations in the business climate, as a source of attraction for FDI, for the group of 29 African countries over the past decade (table 3). At the end of the 1980s, the most attractive countries were Zambia, Mauritius, Chad and Benin. Then, in the early 1990s, Benin, Namibia, Chad, Zambia and Mozambique were ranked as the most performing countries. In the last few years, Namibia, Mali and

Mozambique appeared on the top of the list. Overall, we found that the ranking has been relatively stable over time with about the same strong and weak performers, suggesting that it takes time to establish a good or bad reputation.

Table 3. Comparison over time of the business climate for FDI in Africa

Rank	Average 1986-1990	Average 1991-1994	Average 1995-1997
1	Zambia	Benin	Namibia
2	Mauritius	Namibia	Mali
3	Chad	Chad	Mozambique
4	Benin	Zambia	Zambia
5	Rwanda	Mozambique	Chad
6	Niger	Angola	Senegal
7	Congo, Rep.	Mauritius	Angola
8	Central African Republic	Senegal	Benin
9	Guinea	Ghana	Mauritius
10	Namibia	Uganda	Cote d'Ivoire
11	Madagascar	Madagascar	Tanzania
12	Angola	Nigeria	Uganda
13	Mozambique	Guinea	Central African Republic
14	Senegal	Rwanda	Ghana
15	Nigeria	Tanzania	Madagascar
16	Cote d'Ivoire	Congo, Rep.	Burundi
17	Kenya	Mali	Rwanda
18	Burundi	Zimbabwe	Zimbabwe
19	Ghana	Malawi	Congo, Rep.
20	Ethiopia	Burundi	Nigeria
21	Malawi	Kenya	Niger
22	Uganda	Cote d'Ivoire	Guinea
23	South Africa	Ethiopia	Malawi
24	Mali	South Africa	Cameroon
25	Congo, Dem. Rep.	Congo, Dem. Rep.	Kenya
26	Cameroon	Cameroon	South Africa
27	Zimbabwe	Niger	Ethiopia
28	Sierra Leone	Central African Republic	Sierra Leone
29	Tanzania (N/A)	Sierra Leone	Congo, Dem. Rep.

A few countries have shown significant changes in their business climate over the past decade. Foreign investors have recognized the progress achieved by countries such as Mali (from 26 in 1986-1990 to 5 in 1995-1997), Uganda (from 24 to 13) and Mozambique (from 13 to 3) where FDI inflows jumped about 600 per cent, 100 per cent

and 90 per cent, respectively, between 1993-1994 and 1995-1997. On the other hand, several countries have seen a severe deterioration of their investment environment: Rwanda (from 6 to 18), Niger (from 7 to 22), and Congo Republic (from 8 to 20). Those countries went through unstable political events during these years, with a strong and negative impact on foreign investment.

What makes a business climate attractive in Africa?

At first sight, there are no apparent patterns that emerge from the ranking presented in the previous section. It could have been a priori argued that the small, non-oil exporting and landlocked countries would have made the strongest effort to improve their business climate to attract foreign investors. There are two – complementary – approaches that can be followed to attempt to define what the successful countries have been doing right. First, an econometric analysis can help to identify the main factors. Second a description of the policy reforms implemented in a few successful countries may be practical. These two approaches are presented below.

The absence of reliable statistical data on most African countries precludes a rigorous econometric analysis. However, as a starting point, we proceeded with panel data and cross-country analyses of the 29 countries presented earlier in which we tested a number of explanatory variables. The selection of these variables was done on the basis of the existing literature and the following equation was chosen:

$$FDIBC_{it} = a_0 + a_1 g_{it} + a_2 IR_{it} + a_3 T_{it} + a_4 TM_{it} + a_5 UP_{it} \qquad (2)$$

with:

$FDIBC_{it}$ = business climate for FDI in country i at time t

g = GDP growth

IR = illiteracy rate (per cent of people aged 15 and above)

T = trade/GDP

TM = telephone mainlines (per 1,000 people)

UP = ratio of urban to total population

Contrary to most econometric studies, we do not try to explain FDI inflows but rather the FDI that does not arise from market size and the natural resources available in the host country. Therefore, the dependent variable used in the regression is our business climate indicator as defined by equation (1). As discussed earlier, we assume that FDI inflows respond to a change in GDP or natural resources with perfect elasticity. To check the robustness of this assumption, we have also estimated the same equation but with FDI inflows as a dependent variable and GDP and natural resources as explanatory variables. We found the respective elasticities of 0.91 and 0.92 and 1.4 and 1.2 in our panel and cross-country regressions (see table 4, third column).[11]

A brief explanation might be necessary for our selection of explanatory variables, which has been partly driven by the availability of data in the World Bank's database. [12] The economic growth rate should influence positively the business climate for FDI as it reflects an improvement in economic performance. Most recent studies have also evidenced that the degree of openness, as measured by the trade share in GDP, should influence positively foreign investors through trade liberalization and higher competitiveness. The illiteracy rate should be inversely related to the availability of relatively skilled labour – a major factor in the location decision of TNCs. The number of telephone lines per 1,000 people is viewed as an indicator of infrastructure and communication development. Finally, the recent literature has argued that investors can be lured by concentration of other companies or customers, since it reduces their transport costs and there are evident economies of scale in the development of backward and forward linkages. This argument might be partially captured by the share of urban population (as a percentage of total population). Note we will also test the relationship

[11] Wheeler and Mody (1992) found that market size had a positive influence on capital expenditures by manufacturing affiliates of United States TNCs between 1982 and 1988, with an elasticity of 1.57. Elasticity for the highest income countries was 1.86, while that for the lowest-income countries was 0.74.

[12] For a good review of determinants of FDI in the African context, see Srinivasan (1999). Note that we tested additional explanatory variables to those reported in the text such as income per capita and a dummy variable for landlocked countries. However, those do not appear to influence significantly the business climate index.

between our indicator of business climate and the political and financial risks indicators reported in the preceding section.

Table 4. Econometric results: sensitivity of business climate to policy variables (T-statistics in parenthesis)

	Panel data [a]		Cross Country	
Dependant variable	FDI business climate	FDI inflows	FDI business climate	FDI inflows
Economic growth	0.123 *(1.90)*		0.101 *(1.71)*	0.587 *(1.96)*
Trade openness	0.163 *(2.43)*	2.812 (3.23)	0.172 *(1.94)*	1.812 *(1.50)*
Illiteracy rate	-0.209 *(-0.39)*	1.097 (1.09)	0.139 *(1.33)*	0.489 *(0.80)*
Telephone lines	-0.0404 *(-0.51)*	-0.407 (-0.42)	0.0129 *(0.15)*	-0.144 *(-0.46)*
Urban population	-0.978 *(-1.21)*	-0.228 (-1.26)	-0.0937 *(-0.49)*	-0.525 *(-0.63)*
GDP		0.91 (3.97)		1.415 *(4.28)*
Natural resources		0.92 (7.04)		1.214 *(3.89)*
Adj R^2	0.08	0.433	0.04	0.56
Number of observations	236	236	29	29

[a] Fixed-term effects were used for our panel data regressions.

We estimated equation (2) for the panel data of 29 countries over the period 1990-1997. Alternatively, we proceeded with cross-country regressions using the average values of the selected variable during the same period. The panel data regression includes fixed-term effects because the results from testing the homogeneity of such effects indicate that the changes in the FDI business climate include critical time-correlated elements common to all countries.

The estimated results of our panel regression indicate that GDP growth rate and trade openness have been positively and significantly correlated with the investment climate in Africa (table 4).[13] The positive impact of trade openness seems to confirm the arguments that trade liberalization leads to a more general reduction in administrative

barriers and improve the business environment in the host economy – countries with low trade barriers also tend to have low barriers to FDI – as well as conveys the right signal to the international business community (Lall, 2000). In a more specific context, free trade zones have been much successful in attracting FDI with stable, growing economic environment and trade liberalization (Madani, 1999). In contrast, the illiteracy rate, the number of telephone lines and the share of urban population do not appear to have been major determinants in the business climate for FDI in the region. Those results corroborate those obtained in the cross-country regression. Note that we also tested the impact of political and financial risks (as measured by ICRG and II), but these did not appear significant in the business climate in our (cross-country) regressions. These findings are not surprising in view of the significant differences in the rankings presented in table 2, but contradict somewhat the results obtained in other studies. For example, Zdenek Drabek and Warren Payne (1999) found a highly positive correlation between the ICRG index and FDI for a sample of countries, including both industrial and developing countries. The inclusion of only four African countries in their sample may explain the difference between their and our estimated results.[14]

The above results are indicative but should be interpreted with caution because of several statistical and econometric problems. There are numerous data shortcomings in most African countries.[15] For example, it would be interesting to separate how much of the FDI inflows were the result of privatization receipts; but the data were not consistent and available for the surveyed countries over a sufficient period of time. Also, the variables used in the regressions may capture imperfectly the relationship with the business climate; for example the number of telephone lines does not always reflect the quality and costs of the telecommunication infrastructure in each country. The same problems can be associated with the illiteracy rate and the urban population. The estimated effects of the GDP growth and trade openness might be biased because of

[13] Our findings are consistent with the results obtained by Elbadawi and Mwega (1997) in a recent regression analysis of FDI in Africa.

[14] A closer look at the data indicates that the variations in the ICRG index are not large across African countries, which are all at the bottom of the ranking. The influence of the political climate as investors' decision may only occur when there are significant differences across countries, which is the case in the Drabek-Payne sample as it includes countries such as Denmark and Sierra Leone.

causality problems since changes in the business climate may determine and be determined by the GDP growth rate. Foreign companies may simultaneously follow or push the trade liberalization effort in a country.

To circumvent these statistical and analytical shortcomings, one could use more sophisticated econometric techniques or alternative indicators. Instead, we propose to examine more closely the experience of two individual economies – Mali and Mozambique – that have shown major improvements in their business climate during the 1990s, as reported in table 3.[16] If, in terms of FDI growth, the performance of Mali appears less impressive, it has to be taken into account that the its geographical position (landlocked and not close to the South African market) is not as favourable as that of Mozambique.

What have Mali and Mozambique been doing right? This can be hard to summarize because establishing an attractive business climate for FDI is a multi-dimensional effort. Yet, a few major actions can be identified (see table 5 for details and chronology). First, it appears that these two countries have established a stable macroeconomic environment, at least by regional standards, for a prolonged period of time. The political climate also became secure after a period of high instability. Both countries used aggressive trade liberalization and privatization programmes (especially Mozambique) to attract foreign investors. The Governments approved important pieces of legislation, including new Mining (1991) and Investment (1995) Codes in Mali[17] and a new Industrial Free Zone regime in Mozambique (1994). Moreover, the adoption of international treaties related to FDI helped to increase the Governments' visibility in the international business community as well as provided additional insurance to potential foreign investors. Last but not least, the Presidents have played an important role in promoting their countries abroad, both in the case of Mali and Mozambique.

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[15] As indicated in the previous footnote, we tested additional variables.

[16] It has to be noted that preliminary indications shows that if Mozambique remained the economy with the most attractive business climate in 1998, Mali declined to seventh place in 1998 from fourth in 1996/1997.

Another interesting element is that FDI inflows were triggered by the implementation of a few large projects such as the MOZAL project in Mozambique. True, those projects were initially triggered by the presence of natural resources, but they have contributed to put firms these two countries on the radar screen of international investors. The same argument obviously applies to privatization.[18] As an illustration of this multiplier effect, it suffices to look at the investment projects financed by the International Finance Corporation (IFC) – the private arm of the World Bank Group – in Mozambique and Mali over the past few years. Those investments range from projects in banking to printing and tourism, for a total commitment of $65 million and $134 million in Mali and Mozambique, respectively, as of June 1998. Interestingly, the IFC's portfolio in Mozambique was the largest in Africa, while that in Mali ranked in sixth position, greater than that in Nigeria, Cameroon or Ghana. We believe that the IFC's portfolio allocation illustrates well the interest of the international private community in these two countries and the progress that they have achieved in their business climate.[19]

[17] See also UNCTAD and ICC (forthcoming).

[18] One of the positive externalities of the MOZAL project in Mozambique has been its impact on the Government's commitment to reduce administrative barriers. For fuller details, see Wells (2000).

[19] It would be worth exploring further if the IFC investments have been perceived as signals by other private investors that the business climate has been improving in the host country.

Table 5. Major actions in Mali and Mozambique

Area	Mali	Mozambique
• Macroeconomic stability	The macroeconomic indicators improved dramatically, as real GDP growth reached approximately 7 per cent in 1997, up from 0.6 per cent in 1990. Average annual inflation, as measured by the consumer price index for Bamako, was reduced from 12.4 per cent in 1995, to 4 per cent in 1998. Both the external account deficit and fiscal deficit were reduced, and a prudent credit policy was pursued.	The economic growth rate jumped from 4.0 per cent in 1990 to 13.3 per cent in 1997. Inflation was reduced from 70 per cent in 1994 to single digits by 1997.
• Trade liberalization	The trade openness ratio increased from 49 per cent in 1990 to 60 per cent in 1997, with a reduction in tariffs and the elimination of several non-tariff barriers.	The trade openness ratio increased from 53 per cent in 1990 to 63 per cent in 1997. In 1996, the Government rationalized and lowered the tariff structure, averaging around 14 per cent
• Privatization	After a slow start, privatization receipts reached $22 million in 1997, including the sale of several enterprises in the financial and manufacturing sectors.	Mozambique's privatization programme is one of the most active in Africa as well: more than 900 state enterprises have been privatized, including the entire banking sector and a number of state manufacturing firms. The privatization receipts reached $37 millions in 1997.
• Focus on one/ few major projects	Investment projects in the mining sector (gold) were realized by Rand Gold and Ashanti, facilitated by the reform of the Mining Code in 1991.	The development of the new $1.3 billion MOZAL aluminum smelter facility.
• Political stability	In March 1991, a series of clashes between the people and the army culminated in the arrest of the President. In January 1992, the Alliance pour la democratie au Mali (ADEMA), leading a coalition of opposition parties, established electoral dominance, while its candidate was elected President. He was recently reelected in May 1997 for another five-year term.	The General Peace Agreement in 1992 between FRELIMO and RENAMO and the general elections that followed in 1994 were important steps towards national reconciliation and stability. FRELIMO won the first national election. The opposition, RENAMO, retains almost 45 per cent of the seats in parliament.
• Implementation of new laws and accession to international agreements related to FDI	• Mining Code (1991) • Investment Code (1995) • Multilateral Investment	• Industrial Free Zone (1994) • Multilateral Investment Guarantee Agency (1994)

	Guarantee Agency (1992) • Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1994)	• World Intellectual Property Organization (1996) • Convention on the Settlement of Investment Disputes between States and Nationals and States (1995)

It is also revealing to compare Mali and Mozambique with countries such as Kenya and Cameroon, which have been much less successful in attracting FDI in spite of larger local markets and abundant natural resources (table 1). The business indicator for these two last countries shows that they have not been attractive, twenty-fifth and twenty-fourth, respectively in 1996/1997. Indeed, these countries have not been able to focus on any of the actions that have been identified as key elements of the recent success of Mali and Mozambique. Their macroeconomic performance has been below the regional average, their privatization and trade liberalization efforts rather timid, there has been no major foreign investment projects, and only a few legislative changes have been implemented in recent years. Last but not least, these two countries have established a reputation of high corruption and lack of transparency.

A final word of caution might be necessary. Both countries, Mali and Mozambique, have been through a spectacular recovery during the 1990s, after several years of internal disrupt and (dis) investments by foreign companies. The large FDI inflows observed in the past few years might therefore benefit from a catch-up effect in which it was relatively easy to attract investment projects during the initial recovery but that maintaining such a pace would be increasingly more difficult over time. Only a sustained effort in improving the business climate will continue to attract (foreign) investors. And, in both countries, there is still much room for improvement in areas such as infrastructure, transport costs and human capital.

Conclusions

Countries that can offer a large domestic market and/or natural resources have inevitably attracted foreign investors in Africa. South Africa, Nigeria, Ivory Cost, and Angola have been traditionally the main recipients of FDI within the region.

Over the past decade, several African countries have attempted to improve their business climate in an effort to attract foreign companies. Establishing a competitive business climate is a difficult task because it takes time – not only to implement policies but also to convince potential investors. In the case of Africa, it is even more difficult because most countries are not even on the radar screen of most companies. In 1997, we found that Mozambique, Namibia, Senegal and Mali were perceived as the countries with the most attractive investment environments. Those countries were also able to attract substantial FDI inflows, more than countries that have bigger local market (Kenya, Cameroon, Congo) and/or natural resources (Congo, Zimbabwe).

To improve the climate for FDI, an econometric analysis indicates that strong economic growth and aggressive trade liberalization can be used to fuel the interest of foreign investors. Similarly, a closer look at the experience of Mali and Mozambique – two countries that have shown a spectacular improvement in their business climate during the 1990s – reveals that the implementation of a few visible actions is essential in the strategy of attracting FDI. Beyond macroeconomic and political stability, those countries focused on a few strategic actions such as:

- opening the economy through a trade liberalization reform;
- launching an attractive privatization programme;
- modernizing mining and investment codes;
- adopting international agreements related to FDI;
- developing a few priority projects that have a multiplier effects on other investment projects; and

- mounting an image building effort with the participation of high political figures, including the President.

Interestingly, these actions do not differ significantly from those that have been identified behind the success of other small countries with limited natural resources such as Ireland and Singapore about twenty years ago.

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