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MANUFACTURING FDI IN SUB-SAHARAN AFRICA: TRENDS, DETERMINANTS, AND IMPACT



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MANUFACTURING FDI IN SUB-SAHARAN AFRICA: TRENDS, DETERMINANTS, AND IMPACT

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Guangzhe Chen, Michael Geiger, and Minghui Fu*



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* The report was cleared by Albert Zeufack (Practice Manager, GMFDR). The peer reviewers were: Tom Farole (Lead Economist, GCJDR), Apurva Sanghi (Program Leader, AFCE2), and Yoichiro Ishihara (Sr. Economist, GMFDR). Kevin Carey (Lead Economist, GMFDR) also provided comments and guidance. Gelila Woodeneh (Communications Officer, AFREC) designed the cover page.

CONTENTS

- EXECUTIVE SUMMARY v
- INTRODUCTION..... 1
- LITERATURE REVIEW7
 - FDI Determinants.....7
 - Impact of FDI10
- RECENT FDI TRENDS IN NON-RESOURCE-RICH COUNTRIES 13
- CASE STUDIES..... 23
 - Case Study 1: Ethiopia23
 - FDI Trends*23
 - FDI Determinants*.....26
 - FDI Impact and Results*26
 - Case Study 2: Rwanda29
 - FDI Trends*29
 - FDI Determinants*.....31
 - FDI Impact and Results*33
- SUMMARY AND RECOMMENDATIONS 35
- ANNEXES 39
 - Annex 1: Data Definition39
 - Annex 2: Cost of Doing Business in Selected Countries40
- REFERENCES 41

LIST OF FIGURES

Figure 1:	Overall FDI Flows in Africa and the World	3
Figure 2:	Host Country Determinants of FDI: a Theoretical Framework.....	8
Figure 3:	Sectoral FDI in Selected Countries in SSA.....	14
Figure 4:	Top Investors in Sub-Sectors that have Large Job Creation, Greenfield Projects	19
Figure 5:	FDI in Ethiopia: Overall Trends	24
Figure 6:	FDI in Ethiopia: Employment Trends.....	27
Figure 7:	FDI in Rwanda.....	30

LIST OF TABLES

Table 1:	Greenfield Manufacturing FDI in Selected Countries, US\$M	4
Table 2:	Total FDI Investment in Manufacturing by Investor Groups, Percent in Capital	5
Table 3:	Indicators of Relative Magnitude of FDI Inflows to Selected Countries in Africa.....	13
Table 4:	Greenfield Manufacturing FDI Inflows by Sub-Sector, 2003–2014, US\$M.....	15
Table 5:	Greenfield Manufacturing FDI of Country Origin, 2003–2014, US\$M.....	16
Table 6:	Cost of Doing Business: Electricity as a Constraint.....	21

EXECUTIVE SUMMARY

Africa has lagged behind in industrialization; the lack of industrial development has been partially related to the challenge of attracting sufficient foreign direct investment (FDI). In 2013, the average share of manufacturing value added in GDP in Sub-Saharan Africa was 11 percent, almost unchanged from the 1990s. At the same time, the share of the worldwide FDI flows into SSA has been rather low during the same period. In the *Action Plan for the Accelerated Industrial Development of Africa (AIDA)* that were adopted by all the member governments of the African Union in January 2008, the importance of manufacturing development was reiterated and attracting foreign investment was identified as the major priority for the acceleration of Africa's industrialization.

Compared to the past, FDI into Africa is relatively high and more diverse than ever before. FDI flows into SSA have expanded almost six-fold since 2000, reaching a record US\$45 billion and leading to a significantly higher FDI stock (US\$474 billion) in 2013. Still, FDI into Africa is only a fraction of world FDI flows. The more diversified nature manifests in several dimensions: *First*, FDI into Africa is slowly shifting from extractive sectors to services and manufacturing sectors. *Second*, FDI reached a larger geographic scope over the past five years, with increasing shares received by Southern and Eastern Africa. *Third*, there is a significant increase of South-South FDI, including that from new partners led by China, India, and Brazil, and intraregional partners led by South Africa. Manufacturing FDI reflects similar diversification patterns and some African countries such as Ethiopia are building up their manufacturing bases by attracting FDI from new partners.

FDI has proven useful in the past to advance economic development and foster structural change in host countries. Recent literature and empirical evidence suggests due consideration is needed from policy makers to maximize benefits of FDI, such as skills and technological transfer, and foster overall spillover effects to the domestic economy. These arguments are strongly supported by the practical experiences of East Asian Tigers and of China, where FDI contributed significantly to the upgrading and diversification of its industrial structure. A wide variety of policies to maintain macroeconomic stability, increase trade openness, and accelerate the growth of advanced industries were implemented. The evaluation is assumed to vary depending on country, sector, and the actual drivers of FDI.

Manufacturing FDI in SSA is primarily market-seeking. There are three main types—resource-seeking, market-seeking and efficiency-seeking—when looking at FDI in Africa. In reality there are overlaps in these three types. Manufacturing FDI in SSA is mainly market-seeking and its main determinants are market size and market potential. In addition, political and economic stability are important factors considered by foreign manufacturers when they choose the investment location. On the other hand, efficiency-seeking FDI, observed at firm level, is the smaller part of manufacturing FDI in Africa since only a handful of foreign companies are able to take advantage of lower production cost in some manufacturing areas only, such as textile and clothing, and leather and footwear.

Manufacturing FDI in Africa remains relatively undiversified, focusing on raw material (food) processing or end-product assembly, which are characterized by low value addition, even in

those countries that manage to attract significant inflows. In addition, some manufacturing production areas are more successful in attracting foreign investors than others. Those areas differ by host countries. For example, in the last decade, some emerging subsectors included textile and clothing, and leather and footwear in Ethiopia; non-metallic mineral products and motor vehicles and other transport equipment in Kenya; metal products and non-metallic mineral products in Tanzania; metal products and non-metallic mineral products in Uganda; and non-metallic mineral products and publishing and printing in Rwanda. In addition, FDI is traditionally concentrated in the food and beverage subsector in most of the countries. This concentration in low value addition activities may be appropriate in the short run, however, as it is likely to be a first step for economies to integrate into Global Value Chains (GVCs) through exploiting their comparative advantages.

Non-traditional sources dominate FDI in Africa. New partners and African partners have been the main sources of manufacturing FDI. Traditional sources of manufacturing FDI are shrinking but still account for large stocks. The share of investment from China and India increased rapidly, gradually taking over the proportion of investment originating from the EU and the U.S. Intraregional investment continued to soar and largely contributed to the rebound of Africa FDI to the pre-crisis level.

While FDI into Africa generally tends to have relatively high returns of investments, likely reflecting the high risk and low competition environment, profitability in manufacturing is generally even higher compared to other sectors. Recent evidence shows that the overall rate of return of FDI in Africa has been above 9 percent since 2006, higher than the world average of 7.5 percent and developing country average of 8.1 (data for 2011). On the other hand, in Rwanda, manufacturing realized an average return to equity of 24 percent in 2013. This result also partly explains what drives manufacturing FDI from new partners into SSA. Investors from emerging countries are more accustomed to less supportive institutional

environments, and many are more adapted entrepreneurs in high-risk environments.

Manufacturing FDI creates more jobs than FDI in any other sector. Manufacturing has led in job creation among sectors in the reviewed SSA countries such as Tanzania, Uganda, and Ethiopia. According to the most recent FDI data (2013/14), the manufacturing sector in Tanzania accounted for 43 percent of total jobs created, three times more than jobs created in agriculture. Manufacturing FDI also achieved the largest job creation in Uganda in 2012, amounting to 30 percent of the total FDI-driven jobs. Similar patterns are also recognizable in Ethiopia, especially in terms of permanent employment creation. A significant portion of employment opportunities in manufacturing is attributed to non-traditional investors. However, formal training remains insufficient in manufacturing firms.

Unstable supply of inputs and uncertainty of time required for transport and logistics build a binding constraint for manufacturing FDI in Africa. Drawing from empirical evidence and investors' perception, some binding constraints are identified as critical to further improve the performance of manufacturing FDI. The dependence on imported production inputs, erratic electricity supply, and poor trade logistics drive the cost up and pose the threat to the sustainability of FDI. These bottlenecks also lead to production inefficiencies that constrains Africa's integration into the global value chain.

The Ethiopian and Rwandan case studies suggest that the regulatory business climate is attractive for FDI and contributes to the rate of project operationalization. For many manufacturers who are increasingly looking for new destinations to maintain lower cost for their labor-intensive industries, the registration and preparation process is often an experiment to find the most suitable location in which to invest. As such, the low rate of conversion to operability in Ethiopia from the registered projects suggests that some discouraged investors had likely withdrawn after initial setbacks, indicating that improving investor care in some priority sectors is an urgent task to support FDI.

Policy Recommendations

This report offers five policy recommendations that could contribute to the attraction of manufacturing FDI in Africa. To further the benefits of FDI, especially in the manufacturing sector, policymakers in Africa should:

- *First*, manage FDI flows and FDI-related policies in a way that maximizes spillovers in host countries.
- *Second*, realize the emergence of FDI from new partners, especially in manufacturing FDI, and establish platforms that help in the attraction of new FDI.
- *Third*, increase investment on key infrastructure to overcome constraints for manufacturing activities to develop, especially in power supply and transportation and logistics services.
- *Fourth*, take better advantage of the currently dominating market-seeking manufacturing FDI to improve the weak industry base in the short-term. Market-seeking FDI has a sizeable positive contribution to the host economy.
- *Fifth*, strengthen the linkages between domestic material input and foreign manufacturing investment.

INTRODUCTION

In most countries of Sub-Saharan Africa (SSA), the process of industrialization has not taken off in any significant way. The important role of industrialization in economic growth and structural transformation has been recognized by extensive empirical literature and evidence.¹ Moreover, the development of manufacturing and secondary industry is an important step within the industrialization process, usually at its beginning. This process is typically reflected by a significant rise in the share of employment in manufacturing and by the growing share of national income from the industrial sectors (Bagchi 1990). But those signs of industrialization and structural transformation have not been observed in most SSA countries. In the last 20 years, the growth of manufacturing GDP per capita was 1.26 percent on average per year and lower than those of the extractives and services sector, which grew by 1.47 and 1.33 percent on average per year, respectively (Figure 1.1). In addition, the share of manufacturing GDP declined from 14 percent in 1995 to 11 percent in 2013 for SSA as a whole (Figure 1.2).² Furthermore, there is evidence that agriculture contributed almost 60 percent to employment in SSA over the period 2002 to 2012, followed by services with 32 percent, while only a meager 9 percent came from manufacturing (Figure 1.3). Rodrik (2015) describes this as “premature deindustrialization.”³

Foreign Direct Investment (FDI), especially of the manufacturing type can play a catalyst role in the industrialization process. FDI can boost the host country’s economic growth by providing the much needed capital, creating new jobs, generating productivity spillovers, and transferring technology, skills, and management know-how (Prasad et al. 2003). Moreover, with the rise of Global Value

Chains (GVCs), developing countries can jumpstart industrialization by participating in international production networks. The East Asian experience over the last three decades showed how, in a globalizing world, FDI can help leverage investment to upgrade and diversify industrial structures of host countries. The Four Asian Tigers⁴ were the first economies to take advantage of this rise in globalization and FDI flows in the 1980s, followed by China in the 1990s, and Vietnam, Cambodia, and others in the 2000s (UNCTAD 2005). As those countries “graduate” now and diversify into higher value-added industrial and service activities, there is an opportunity for latecomers in the industrialization process to benefit from FDI in manufacturing, especially the labor-intensive kind of manufacturing (Lin 2011). To be able to benefit from this potential FDI it is crucial for potential host countries to position themselves early. Studying the trend and impact of manufacturing FDI and improving the policy framework to maximize the positive impact is therefore crucial. It is not too late for Africa to get ready as Figure 1.4f shows: compared to the primary sector and services sector, manufacturing FDI in Africa has not yet fully taken off (and in fact even declined slightly in value in 2013).

In reality, FDI inflows into SSA represent only a fraction of the world total, yet they are rising fast. Fast economic growth has made SSA a more attractive

¹ See Datta (1952), Kuznets (1966), Bagchi (1990), and Maddison (1995).

² South Africa is an exception to this trend.

³ Rodrik defines this trend as Premature Deindustrialization—since it means “many (if not most) developing nations are becoming service economies without having had a proper experience of industrialization.”

⁴ The East Asian Tigers include four economies: Republic of Korea, Hong Kong, Singapore, and Taiwan. They have maintained high level of economic growth since the 1960s, boosted by exports and rapid industrialization.

BOX A: Overview of Sub-Saharan Africa's Engagement with New Partners in FDI

China's share of total FDI inflows into Africa averaged about 5 percent of annual global FDI flows to SSA over the past decade. China's outward FDI stock in SSA reached US\$24 billion in 2013, up from US\$462 million in 2003. African countries, such as South Africa, Zambia, Nigeria, Angola, DRC, and Ethiopia attracted the lion's share of Chinese FDI (UNCTAD 2013). Chinese FDI presents in a broad range of countries, including non-resource-rich countries in East Africa countries in order to penetrate the domestic and regional markets. Sizable inflows from China are going into manufacturing, construction, and services. The latter includes financial services, ICT, and electricity.

Investment from **India** is also significant. The total stock originating from India in SSA was more than US\$12.9 billion as of 2012, accounting for 3 percent of the total FDI in SSA. India has traditionally concentrated in Mauritius, partly due to the ethnic links and the latter country's offshore financial facilities that are used as transit points of FDI to other countries. As for sector, India has focused on manufacturing such as textile and garment, construction and related activities, as well as services (ICT in particular).

Although still small, **Brazil's** FDI to Africa is on the rise with the Portuguese-speaking countries such as Angola and Mozambique, as well as Ghana, South Africa, and Zambia as main destinations. Angola has been the largest recipient of Brazilian FDI so far, especially in energy, mining, and infrastructure, given the presence of a few large multinational corporations focusing on construction and mining. The Brazilian FDI in Angola reached US\$11.7 billion.

South Africa is the most important source of intraregional FDI in Africa. About 5 percent of total FDI in Africa originated from South Africa, which was the fifth largest holder of FDI stock in Africa as of 2011 (UNCTAD 2012). Most of South Africa's FDI has been directed to Mauritius, Nigeria, Mozambique, and Zimbabwe. According to UNCTAD FDI/TNC database, South Africa holds sizable FDI in mining and quarrying, manufacturing, and finance.

investment destination over the past decade: FDI flows into SSA have expanded almost six-fold, increasing the FDI stock in Africa from US\$148 billion in 2000 to US\$246 billion in 2012. In particular, after the financial crisis, FDI flows quickly returned to the pre-crisis level of US\$35 billion and hit a record US\$45 billion in 2013. Apart from traditional FDI concentration in a few mostly oil-producing countries (Angola, South Africa and Nigeria), FDI has been rising quickly in some fast-growing non-oil-exporters, including Tanzania, Zambia, Uganda and Ethiopia. Figure 1.5 indicates that FDI flows to SSA have become more diversified to different sub-regions. In 2012–2013, the overall increase was driven by increases in FDI in Eastern and Southern Africa. Nevertheless, compared to other regions, SSA FDI inflows only accounted for 3.1 percent in 2013 (Figures 1.5 and 1.6).

Meanwhile, FDI from new partners has played an important role in the rebound, leading to a diversification in the source countries. Since the 2008/09 crisis FDI inflows to SSA have been less volatile than the world average, partly due to consistently rising investments from new partners.⁵ The level of engagement of investors from traditional countries such as from the EU, the U.S. and Japan is

on a decreasing trend since 2008. Still, they accounted for as much as 41 percent of the total FDI inflows in 2012. The rapid increase in FDI from new partners is represented by investments from China, India and Brazil. To illustrate, Chinese FDI in Africa represented 7 percent of total FDI inflows to SSA and reached US\$24 billion in 2013. Also of note is India, which had a FDI stock of almost US\$13 billion or 3 percent of the total FDI in Africa in 2012 (Data from UNCTAD FDI/TNC database). Intraregional partners are also of importance, led by South Africa (which accounts for 5 percent of total FDI in Africa as of 2011, reported by UNCTAD 2012) followed by Nigeria and Kenya. See Box 1 for an overview of the new partners' FDI in SSA.

While FDI in Africa is at historic levels, only a few countries have received significant increases in manufacturing FDI. This again was led by new partners. Only six countries in SSA received the large majority of manufacturing FDI between 2011 and 2014 (*Note:* Data is Greenfield FDI only):

⁵ The term "new partners" in this report refers to non-OECD FDI source countries. Please refer to the detailed classification of country partners in Annex 1.

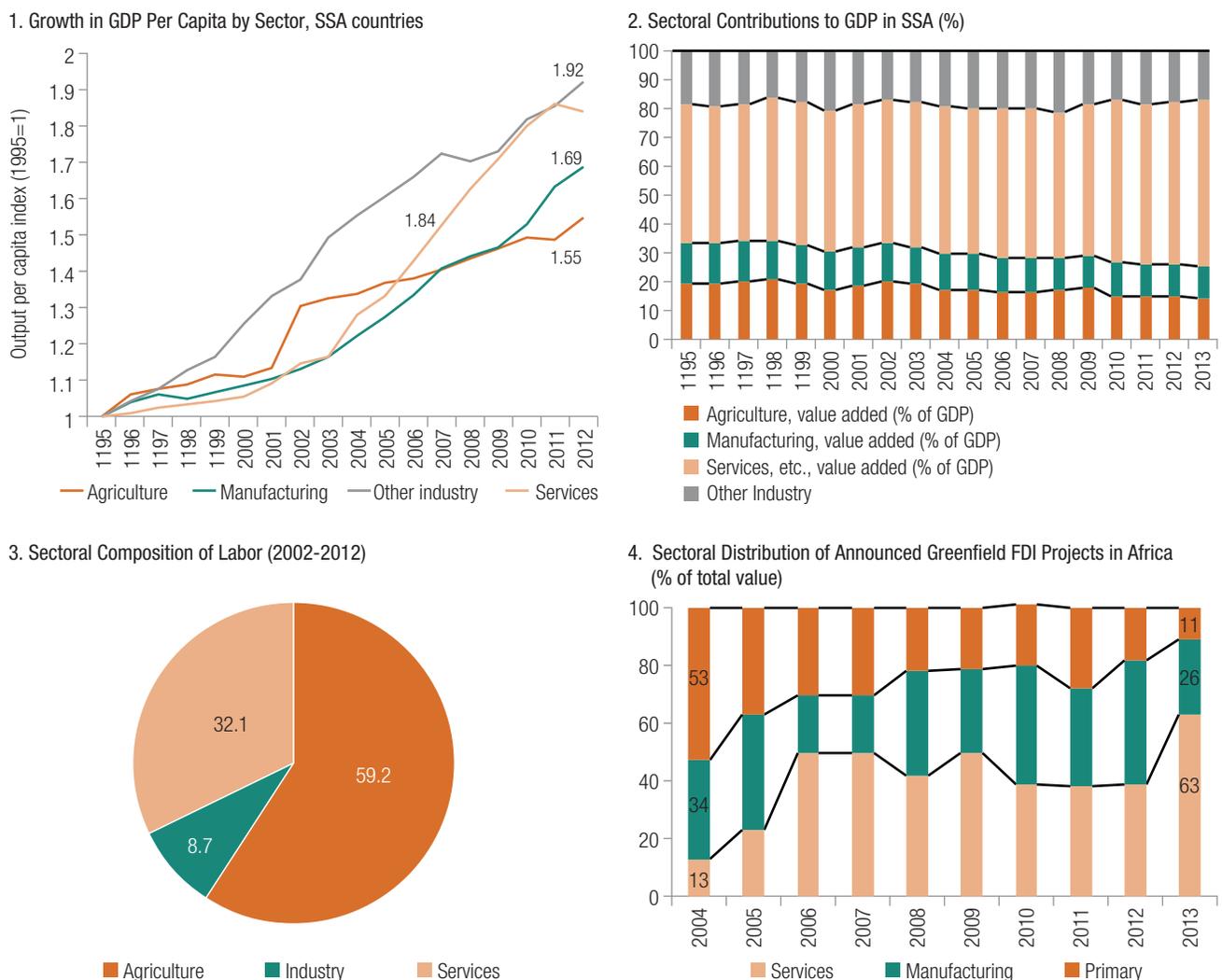
Mozambique, South Africa, Nigeria, Ghana, Zambia, and Ethiopia (Table 1). Similar to trends in overall FDI, FDI from new partners has also played an important role in the manufacturing sector in SSA. Table 2 shows that investment from EU and the U.S. in the manufacturing sector shrank in the last past decade. During the same period, the proportions of overall investment originating from India, China, and South Africa became noteworthy, making up 19 percent of the total capital and 17 percent of the total numbers of projects. While in manufacturing sector, investment from the three countries has even more presence, up

to 31 and 22 percent of the total investment in terms of capital and project numbers, respectively.

Given the rising importance of manufacturing FDI, this paper reviews recent evidence on the trends, determinants, and impacts of such FDI. Some of the emerging findings explored in this paper are:

1. FDI trends, particularly in the performance of manufacturing sector, differ significantly by country and by sector.
2. New partners and African partners have been the main sources of manufacturing FDI; traditional

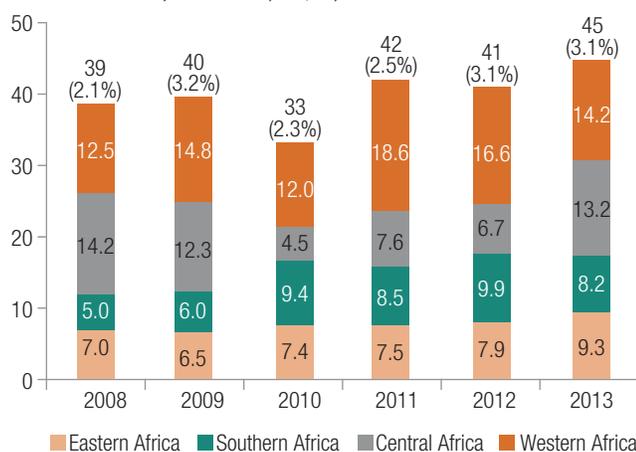
FIGURE 1: Overall FDI Flows in Africa and the World



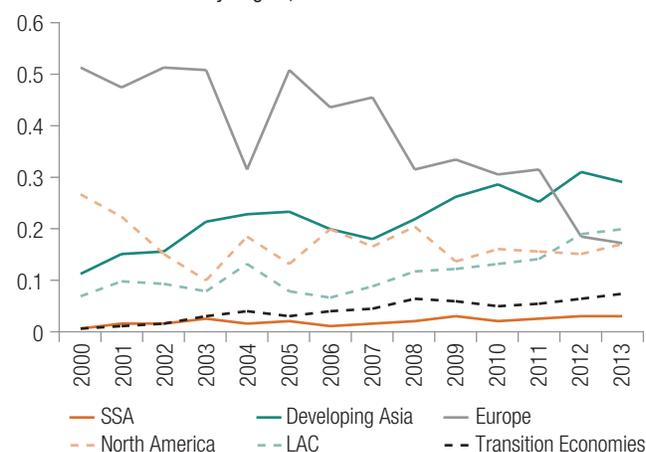
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FIGURE 1: Overall FDI Flows in Africa and the World (continued)

5. SSA FDI Inflows, 2008-2013, US\$bn, Share of World Total in Parenthesis



6. Share of FDI Inflows by Region, 2000-2013



Source: 1.1 State of the Africa Region, Spring 2015, Francisco Ferreira, estimates based on WDI (2015). 1.2 World Development Indicator, 2014; 1.3 International Income Distribution Database; Ferreira, 2015; 1.4, 1.5 and 1.6: UNCTAD, World Investment Report 2014; FDI Statistics.

Note: "Other industry" includes mining, construction, electricity, water, and gas. Population-weighted average of 29 countries for which sectoral value added data can be decomposed into manufacturing and other industry.

TABLE 1: Greenfield Manufacturing FDI in Selected Countries, US\$M

Country	Annual Average (2003–2006)	Annual Average (2007–2010)	Annual Average (2011–2014)
Mozambique	82	1,854	2,568
South Africa	2,002	2,526	1,819
Nigeria	4,987	1,204	1,675
Ghana	375	2,115	1,625
Zambia	430	365	1,561
Ethiopia	38	298	1,031
Kenya	140	99	498
Tanzania	89	346	194
Congo (DRC)	226	243	176
Uganda	65	1,809	164
Angola	363	929	155

Source: fDi Markets Database (www.fdimarkets.com).^a

^a Definition in fDi Markets Database: 1) A project is defined as a cross-border investment in a new physical project or expansion of an existing investment which creates new jobs and capital investment. 2) Projects were tracked based on publicly available information and may include projects that never went into operation.

- sources of manufacturing FDI are shrinking but are still significant in SSA.
- Manufacturing FDI in SSA is mainly market-seeking, aimed at penetrating the local or regional markets.
- Key determinants of FDI in Africa include market size and potential, as well as political and economic stability.
- Investment promotion seems to be instrumental for attracting FDI. But investment climate factors

TABLE 2: Total FDI Investment in Manufacturing by Investor Groups, Percent in Capital

Partners	2003–2006	2007–2010	2011–2014
Traditional Partners			
EU	43%	36%	28%
US	19%	5%	12%
Other Traditional	10%	9%	10%
New Partners			
India	10%	14%	19%
China	8%	12%	5%
Middle East	1%	1%	2%
LAC (mostly from Brazil)	NA	1%	0.4%
Other new partners	7%	2%	5%
Intraregional Partners	2%	19%	19%
Grand Total	100%	100%	100%

Source: fDi Markets Database (www.fdimarkets.com).

Note: EU includes Austria, Belgium, Bulgaria, Croatia, Republic of Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the UK.

- are crucial for sustaining FDI in host countries (e.g., increasing the operational or survival rate of FDI projects).
6. For manufacturing FDI, the binding constraints are the shortage of production inputs, power outage, and trade logistics, which hinder the manufacturing FDI's integration into the value chain. Findings suggest that the binding constraints can be reduced by improved investment climate.
 7. The rate of return of manufacturing FDI projects is found to be higher compared to other sectors due to the high risk and low competitive environment in Africa; this fact is particularly valued by non-traditional investors.
 8. A significant portion of employment opportunities in manufacturing is attributed to non-traditional investors.

The paper is organized as the following: i) the paper conducts a literature review on the role, determinants, and the impact channels of FDI to set up a framework for empirical analysis and serve as a rationale for the focus on manufacturing FDI in non-resource rich SSA countries; ii) the analysis reviews recent trends and impact of FDI in these countries, with a focus on FDI from new partners; and iii) more in-depth case studies in selected countries are added to further examine the determinants and impact channels of FDI.

LITERATURE REVIEW

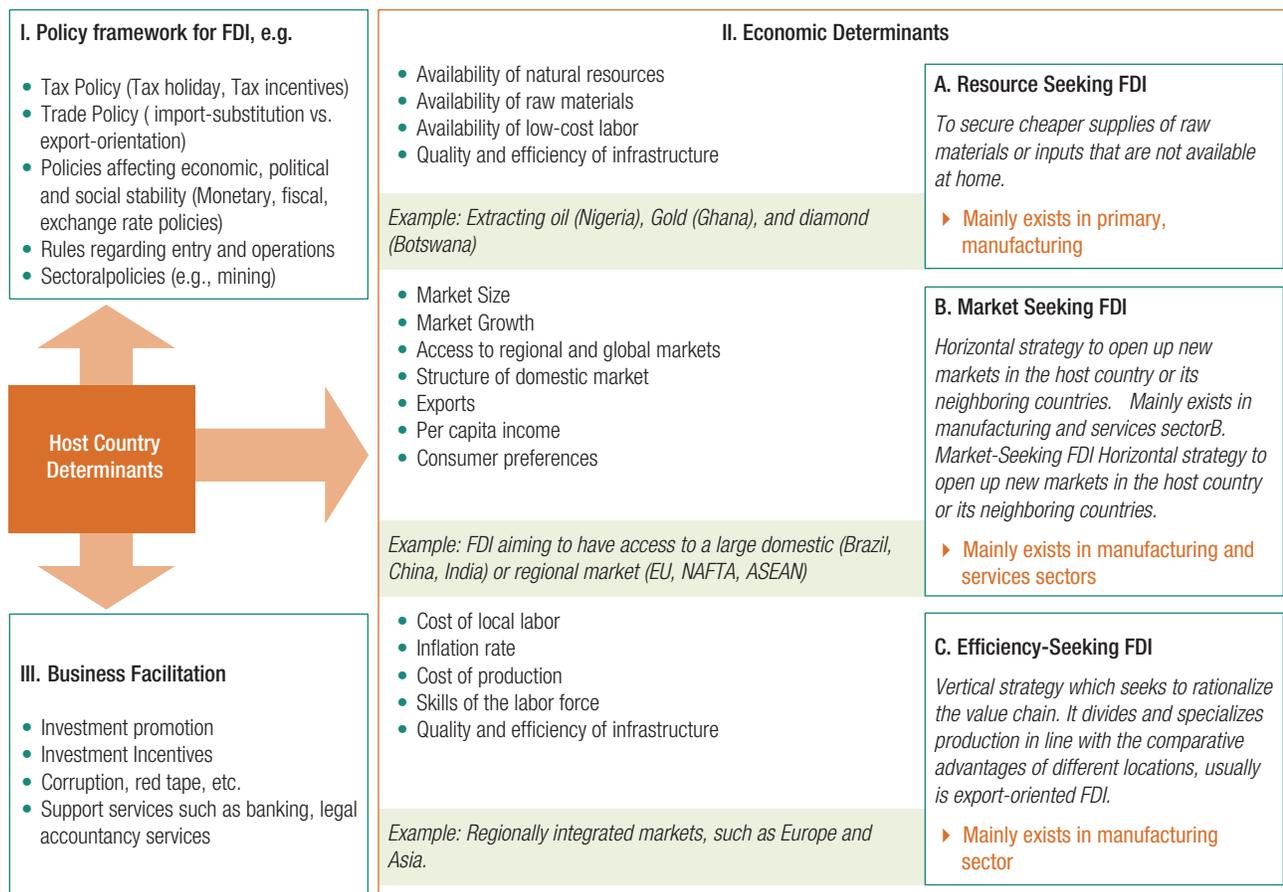
FDI Determinants

FDI can bring both benefits and costs to host countries, which suggests that FDI needs to be managed actively to maximize benefits. Common definitions of FDI emphasize the long-term character and the fact that FDI carries a controlling ownership (e.g., at least 10 percent or more of the equity shares) with the enterprises in the host country (see definitions of FDI by OECD, IMF, and the UN Statistics Division, for instance). Therefore, FDI can offer not only stable capital inflows but also job opportunities, technology transfer, know-how of management, and access to foreign markets because of the intention of a long-term investment that requires the ability to monitor and control the investment (Prasad et al. 2003). More recent studies also show that FDI is recognized to have positive spillover effects on local firms through increased productivity, skills formation, and value chain integration (Lederman et al. 2010; Farole and Winkler 2014). Nevertheless, there are also potential drawbacks to FDI, including a deterioration of the balance of payments as profits are repatriated, a lack of positive linkages with local communities, and a lack of absorptive capacity for taking advantage of FDI spillover effects (OECD 2002). Given these characteristics of FDI, it is prudent for policymakers to carefully evaluate the trend and impact of FDI on an ongoing basis so to maximize the benefits of FDI.

Moreover, governments can play a role to harness the potential of spillover effects offered by FDI in the context of GVCs. Determinants of spillovers from FDI are (Farole and Winkler, 2014): *First*, a quality investment climate, including stable political and social conditions, favorable business environment, and good access to land and infrastructure. *Second*, open

trade policy is critical for attracting FDI in sectors that are strongly linked to global production networks. *Third*, absorptive capacity and host country characteristics matter to determine the scale and nature of spillovers from FDI. Absorptive capacity depends on factors such as the technological gap, human capital and competition. Critical host country characteristics to maximize spillovers are labor market regulations, intellectual property rights, access to finance, and learning and innovation infrastructure. Therefore, policy makers can help the integration into GVCs by improving the investment climate and formulating open trade policies that help integrate the economy into global production networks. Increasing human capital through better and more education and closing the technological gap through key infrastructure investments are examples of efforts that increase absorptive capacity and maximize the host country characteristics.

There is a wide array of FDI determinants identified in the literature about the motivations for foreign investors to invest. Theoretical and empirical studies largely agree that the determinants of FDI inflows vary depending on sectors and regions. The decision factors to invest in a foreign country range from economic, political, and social factors to cultural factors; these factors tend to be mutually reinforcing. Some studies have further divided the factors influencing FDI inflows in developing countries into two groups: i) on the demand side, factors are related to the intrinsic motivations of foreign investors (Calvo et al. 1993); and ii) on the supply side, the motivating factors are those which characterize the host countries, including variables such as macroeconomic policy and performance, trade openness, tax levels and incentives, the quality of legal and other institutions, market size

FIGURE 2: Host Country Determinants of FDI: a Theoretical Framework

Source: World Bank staff own compilation, based on research of UNCTAD, World Investment Report (1998); IFC Investment Climate website (accessed 2015); Dunning (2000); and Basu and Srinivasan (2002).

Note: There is a fourth type of FDI by motivation, which is strategic-asset seeking FDI. This type of FDI takes place through cross-border mergers and acquisitions for a variety of strategic reasons, e.g., to access research and development, innovation, and advanced technology. It is barely present in Africa so that it is not considered in this analysis.

and potential, the level of development of human capital, etc. (Morisset 2000; Collins 2002). The role of factors on the supply side stresses that countries offering what foreign investors seek stand a greater chance of attracting more FDI. The view of the demand side, which identifies factors that enhances the attractiveness of FDI, is important for policy makers.

Looking at a combination of investor motivations and host country features allows for the narrowing and classification of the determinants of FDI to inform the analysis. The literature identifies a set of analytically distinctive features that serve as a framework to study FDI in SSA, especially in the

manufacturing sector. Based on several recent studies,⁶ this study uses a framework (depicted in Figure 2) that combines investor motivations (resource, market, or efficiency-seeking) and host country features (e.g., the sectors of investment and policy environment). This provides a guide for the comparison of determinants across countries and provides a basis for quantitative analysis and case studies on what contributes to the successful and sustainable use of FDI in SSA.

⁶ This framework is developed based on the information from UNCTAD, World Investment Report (1998); IFC Investment Climate website (accessed 2015 at www.wbginvestmentclimate.org); Dunning (2000); and Basu and Srinivasan (2002).

Market size, access to natural resources and low cost of labor are major determinants of FDI in Africa.⁷ Morisset (2000) identifies the important role of market size, as is evidenced by the almost perfect positive correlation (0.99) between FDI inflows and GDP for a group of 29 African countries during 1996 and 1997. In addition, market size also includes market access to third country markets. Jaumotte (2004) finds that regional trade agreements have a positive impact on the FDI received by the member countries. Similarly, Asiedu (2003) studies 22 African countries observed from 1984 to 2000 and finds that countries that are endowed with natural resources will attract more FDI. Moreover, a number of studies, such as Wheeler and Mody (1992) and Mody and Srinivasan (1998) find low cost of labor as a significantly important FDI determinant.

In addition, there is an increasing importance of policy and institutional factors, such as trade openness and human capital, endowments that affect FDI in Africa, especially in non-resource-rich countries. Several empirical studies have shown that other things equal, countries whose policies are most conducive to foreign investors stand a better chance of attracting FDI. Based on panel regression analysis of 29 African countries between 1990 and 1997, Morisset (2001) attributes successes in attracting FDI in most SSA countries to their achievements in improving their investment climate, and argues that proactive policies and reform-oriented governments can generate FDI interest. Also, Bende-Nabende (2002) analyzes the experiences of 19 SSA countries in 1970–2000 and finds that the most dominant long-run drivers of FDI in SSA are market growth, export-orientation strategy, and FDI-related policy liberalization. Some recent studies also underscore the importance of enabling environments in SSA. Lederman et al. (2010) uses firm-level data across in 13 SSA countries and points out that trade openness is especially important in comparison with other regions. Some industry examples include textiles in Lesotho and agro-food processing in Swaziland in 1990–99. Similarly, using manufacturing and services firm-level

data for 30 SSA countries between 2000 and 2006, Kinda (2014) concludes that host country infrastructure, human capital, and institutions are major drivers for the location of foreign firms in SSA.

Previous experiences in China and India in receiving FDI also provide a useful comparative perspective on how policy and institutional conditions, such as the investment climate, affect FDI and their development impact. Both China and India possess the necessary economic factors to attract efficiency-seeking and market-seeking investments. Given the common feature of large and growing domestic markets for differentiated goods and services and a large pool of low cost semi-skilled and skilled labor, the differences in the policy and institutional conditions likely determine the pattern of FDI in these two countries (Patibandla 2002). India started to undertake market reforms in the early 1990's. It pursued for a long time import-substitution strategy relying on domestic resources and firms, and tried to encourage FDI only in high-tech industries. These market and policy conditions attracted more market-seeking FDI in service. China, on the other hand, opened up to FDI in Special Economic Zones in the 1980s and 90s and has progressively liberalized its economy (Huang 2002). FDI inflows to China include both market-seeking and efficiency-seeking, but their relative importance shifted over time, where the latter has become more dominant in recent years (UNCTAD 2012). Over the period 1985–2010, both countries showed increases in the trend of FDI. But most of FDI in China flowed to the export-driven manufacturing sector. In contrast, India showed an impressive decline in the share of manufacturing FDI, but the bulk of FDI has flowed into the service sector (Naudé et al. 2013).

FDI determinants differ when looking at different sectors, but empirical evidence on the extent is limited. There is some evidence differentiating between sectors and types in the drivers of FDI and

⁷ See Mody and Srinivasan (1998), Morisset (2000), Asiedu (2003), Rojidi et al. (2009), and Hailu (2010).

only few are looking at this issue in Africa. Kinda (2014) disaggregates non-resource-based FDI data in SSA into vertical FDI (foreign firms producing for export—efficiency-seeking in this paper) and horizontal FDI (foreign firms producing for local markets—market-seeking in this paper), and establishes that taxation is not a key driver for either type of FDI. Moreover, there is considerable contrast in behavior between market-seeking and efficiency-seeking FDI. Market-seeking is attracted to areas with higher trade regulations, highlighting the investors' interests in protected markets and import-substituting investment. Compared to efficiency-seeking FDI, market-seeking FDI is affected more by financing and human capital constraints and less by infrastructure and institutional constraints. Lemi et al. (2003) studies how the role of uncertainty in affecting FDI differs by industrial groups by analyzing the U.S. manufacturing FDI and U.S. non-manufacturing FDI flows in a sample of host countries in Africa. They find that for U.S. manufacturing FDI, political stability and government policy commitment stand out as important factors; whereas these factors are not significantly important for U.S. non-manufacturing FDI. Likewise, recent evidence from the Middle East and North Africa region suggests that political instability has a sizable effect on the FDI composition in non-resource tradable goods sector (Ianchovichina et al., 2015).

Impact of FDI

FDI can play a constructive role by transferring capital, skills and know-how, but attracting FDI doesn't automatically guarantee economic development. Previous findings suggest that whether FDI contributes to development depends on macroeconomic and structural conditions in the host economy (UNCTAD 2005). And a recent study further established that long term and sustainable development comes from the aggregated productivity growth brought by FDI spillover effects (Farole and Winkler 2014). The successful cases are from developing Asia. China has shown how foreign investment has

exhibited positive impact on employment, productivity, and exports. Examining firm-level data covering 1998–2007 in China's manufacturing sector, Du et al. (2011) conclude that trade reforms and tax policies adopted by China have generated productivity spillovers, especially for backward linkages. They also find that China's successful industrial policy harnessed the FDI spillovers potential, as evidenced by the finding that foreign investors who received corporate tax breaks transmitted larger spillovers to domestic enterprises. Studies on the relations between tax policies and growth spurred by FDI in India share common findings (Nataraj 2011).

The literature finds that motivations for FDI (i.e. the determinants) affect the impact. Some show that efficiency-seeking FDI exhibits stronger growth effects compared to others, while others argue that actual investments often have mixed and shifting motivations and thus make the analysis by motivation inappropriate in the first place. Yet, the following findings stand out.

Resource-seeking FDI is by-and-large regarded as having a limited overall effect on economies.⁸ Some empirical studies establish that there has been an inverse relationship between the intensity of natural resource and growth between 1970 and 1990 (Sachs and Warner 1995). Case studies in Africa show that resource-seeking FDI usually creates less job opportunities and won't exhibit positive spillover effects in the short term, compared to other types of FDI. Selhausen (2009) uses panel regression of a dataset covering 72 developing countries (33 SSA countries) and observes the differences of impact between resource-seeking and non-resource-seeking FDI (primarily the manufacturing sector in his paper). He argues that as long as resource-seeking FDI dominates, SSA is still unable to benefit from its return on capital potential. Moreover, compared to developing countries in Asia and Latin America, SSA attracts higher portion of

⁸ Existing literature mainly examines the impact of resource-seeking FDI by considering this type of FDI as natural resource-based, somewhat different from the definition of "resource-seeking" in this paper.

resource-seeking FDI and the natural resources are mainly traded away rather than being processed in the region itself. Therefore, resource-seeking FDI doesn't translate into sustained economic growth nor institution change, but consequently crowds out the seconded wave of manufacturing. China's experience shows that FDI related to manufacturing will have a bigger impact on economic growth than extractive-sector FDI (Buckley et al. 2012).

Market-seeking FDI has a sizeable positive contribution to the host economy. Market-seeking FDI in services and some parts of manufacturing can benefit host countries' consumers by creating jobs, introducing new products and services and by modernizing local production and marketing. But there are divided views on the results of the competition effect brought by market-seeking FDI. Nunnenkamp and Spatz (2012) conclude that severe competition may lead to the crowding out of local firms, especially if foreign enterprises command superior market power. Moreover, in the long run, the host countries' balance of payments is likely to deteriorate through the repatriation of funds since market-seeking FDI often generates less export revenues. Whereas in a case study on exploring the scope and nature of spillovers in three apparel exporting countries (Kenya, Lesotho, and Swaziland) in SSA, Farole and Winkler (2013) find that market-seeking FDI is more likely to be integrated into the domestic economy, to make greater use of local markets and to provide assistance to suppliers than efficiency or resource seeking investors.

Efficiency-seeking FDI has probably the strongest growth impact of all types of FDI. Yet, the growth impact of FDI in general is not very pronounced as shown in a recent analysis of 38 SSA countries (Calderón and Ha, 2015). On the other hand, Nunnenkamp and Spatz (2012) study the FDI originating from the U.S. in manufacturing and service industry in developing countries. They conclude that one would expect a relatively strong growth impact of FDI in industries that attract efficiency-seeking FDI for several reasons: i) efficiency-seeking FDI is more

likely to bring in technology and know-how that is compatible to the host countries' level of development; ii) efficiency-seeking FDI is more likely to enable local suppliers and competitors to benefit from spillovers through adaptation and imitation; and iii) efficiency-seeking FDI should generate foreign-exchange earnings for host countries. In addition, they argue that the growth impact of market-seeking FDI should be weaker than the growth impact of efficiency-seeking FDI.

Nevertheless, from the perspective of spillovers, it is not always the case that efficiency-seeking FDI is most beneficial to the host economy. Past experience has shown that efficiency FDI is more likely to enable local suppliers and competitors to benefit from spillovers through adaptation and imitation, e.g., manufacturing FDI in East Asia. But some evidence in SSA reveals that spillovers delivered by efficiency-seeking manufacturing FDI are limited because of the constraints of local absorptive capacity (Farole and Winkler, 2013). In addition, with the emergence of GVCs, the boundaries between market- and efficiency-seeking FDI are not always clear-cut and often both kinds even convert to each other. For example, once market-seeking FDI succeeded through the establishment of strong local production networks, those networks can relatively easily be exploited for efficiency-seeking FDI.

Any impact assessment of FDI also depends on the sectoral characteristics of the investment. Often, empirical analysis do not account for the sectoral composition of FDI when analyzing the FDI impact in SSA. But Alfaro (2003) explores the relationship between economic growth and sectoral FDI in a group of 47 developing countries. The study finds that FDI flows in the different sectors of the economy (primary, manufacturing, and services) exert different effects on economic growth. While total FDI has an ambiguous effect on the real per capita GDP growth rate, manufacturing sector FDI has a positive, significant effect on growth. FDI in the primary sector has a significant, negative effect on growth; and the service sector result is ambiguous. Using sectoral FDI data in 12 Asian economies, Wang (2002) reaches similar conclusions.

The study finds that manufacturing FDI has a greater positive effect on growth than aggregated FDI in the sample and primary sector FDI has a negative effect on growth. Comparing the median growth rates between subgroups of FDI data in 37 developing countries,

Nunnenkamp and Spatz (2012) conclude that the link between FDI and economic growth is stronger in the services sector than in the manufacturing sector. In addition, within the manufacturing sector positive growth effects are found in efficiency-seeking FDI.

RECENT FDI TRENDS IN NON-RESOURCE-RICH COUNTRIES⁹

When FDI performance is zoomed in at the country-level the FDI trend measures are not universally increasing. For the sample countries (See Figure 3.1 and Table 3), FDI into Tanzania has been the highest on average over the past decade within east Africa. The growing trends with all ratios indicate a relatively sustainable FDI flows into these countries. Uganda saw a consecutive three-year growth in FDI after a moderate decline in 2010, leading to an overall increase over the past decade. Ethiopia was the top performers during 2013, with the size of FDI more than tripled compare to the figure in 2012. Similarly, FDI in Kenya almost doubled during the last year. Despite the fast growth rate, FDI in Kenya and Ethiopia remains relatively weak considering the size of its economy, as evidenced by the relatively low ratios. In contrast, Rwanda, as a small land-locked country, has kept pace with the overall increasing FDI trend in Africa and continues to attract certain levels of FDI, which as a share of its GDP or per capita is quite significant. These findings are more consistent with the literature that emphasizes the importance of country-level institutional and policy factors in attracting FDI.

Moreover, FDI trends differ significantly by sector, indicating that most SSA countries continue to

face the challenge of obtaining reasonable amount of FDI in more diversified sectors. As shown in Figure 3.2, the FDI composition in some countries is clearly more diversified than in others. Ethiopia's FDI is dominated by the manufacturing sector. In Kenya, FDI in the services sector has far exceeded the investment in the manufacturing sector. The mining sector remains the largest sector in Uganda and Tanzania but Tanzania has given relatively more focus on manufacturing. While in Rwanda, most of FDI was directed to the services sector such as ICT and finance, as well as manufacturing.

With respect to FDI in manufacturing, the performance of subsector al allocation also varies across countries. Each country has attracted a certain level of investment in non-metallic mineral products manufactures. Food, beverages, and the tobacco industry also has large presence across countries, except in Rwanda. Motor vehicles equipment is another widely distributed industry. Certain types of manufacturers

⁹ Notes: i) Sample countries have been selected based on the relevance for the manufacturing sector and data availability; and ii) in view of the fact that Greenfield projects are the major form for investors to enter the manufacturing sector in Africa, this section uses data from fDi Markets, a cross-sectional project-level database operated by the Financial Times newspaper that tracks data on cross-border Greenfield investments.

TABLE 3: Indicators of Relative Magnitude of FDI Inflows to Selected Countries in Africa

Country	FDI/GDP			FDI/GFCI			FDI/Export			FDI per capita		
	02–05	06–09	10–13	02–05	06–09	10–13	02–05	06–09	10–13	02–05	06–09	10–13
Tanzania	3.79	4.35	6.30	0.18	0.15	0.19	0.20	0.18	0.22	12.77	19.68	35.78
Uganda	3.53	5.93	5.18	0.17	0.27	0.21	0.28	0.31	0.23	9.63	24.00	26.60
Ethiopia	4.04	1.44	1.39	0.13	0.05	0.04	0.29	0.11	0.10	5.24	3.41	5.87
Rwanda	0.27	1.89	1.52	0.02	0.09	0.06	0.03	0.16	0.12	0.62	8.21	9.20
Kenya	0.29	0.76	0.67	0.02	0.04	0.03	0.01	0.04	0.03	1.29	6.52	7.48

Source: World Bank staff own calculations, based on data from World Development Indicator (2014).

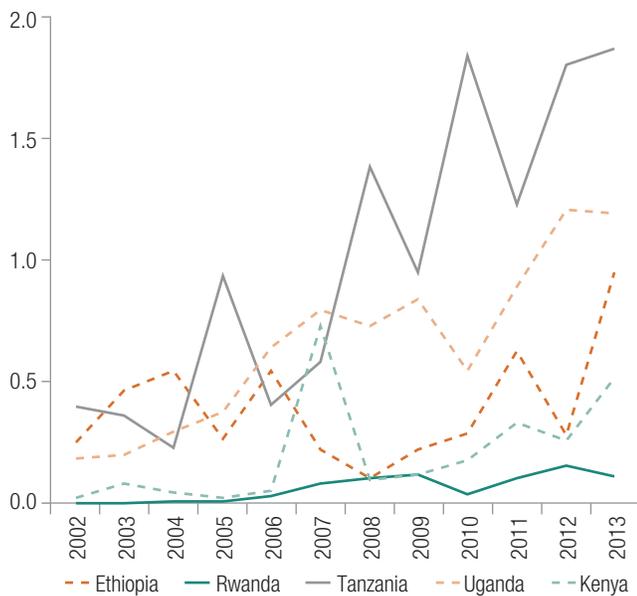
have favored some countries. For example, Ethiopia holds large amount of FDI in textiles, clothing and leather, and footwear. Other prominent examples include electrical and electronic equipment in Kenya, and metal and metal products in Tanzania and Uganda (see Table 4).

However, manufacturing FDI in SSA characterized by low value addition and the concentration

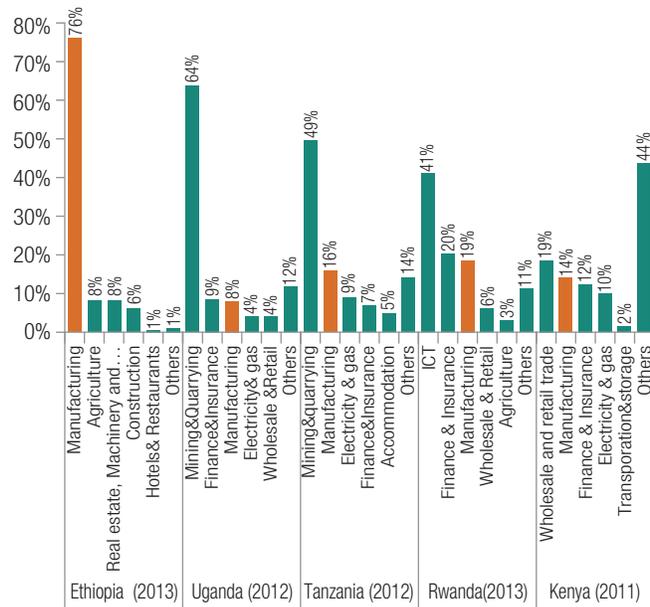
in specific sub-sectors may be appropriate in the short run. With the emergence of GVCs, low value addition is recognized as a starting point to benefiting from global trade and investment integration. In the long run, by specializing in the tasks in which the countries have comparative advantage, countries have greater opportunities to achieve the FDI-induced productivity gain, which will contribute to the

FIGURE 3: Sectoral FDI in Selected Countries in SSA

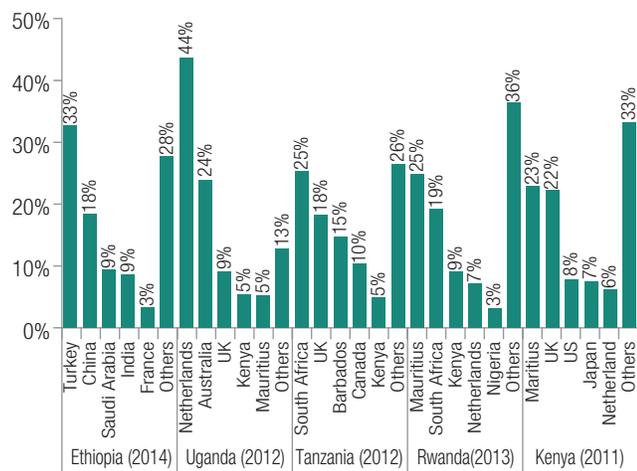
1. Foreign Direct Investment, Net Inflows (BOP, Current US\$bn)



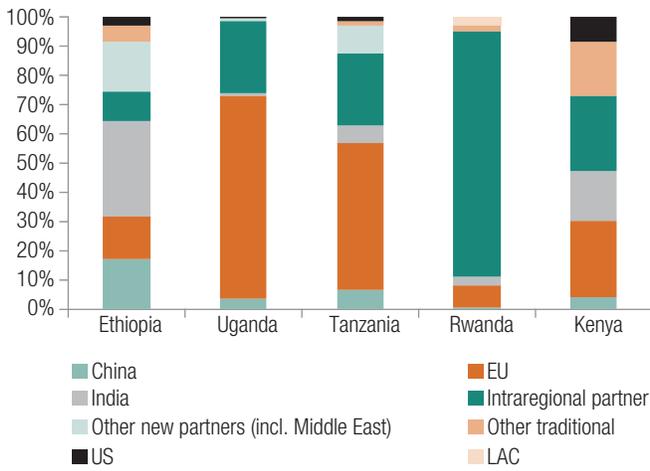
2. Main Sectors of FDI in Sample Countries by FDI Stocks, % of total value



3. Top Investors of FDI in Sample Countries by FDI stocks, % of total value



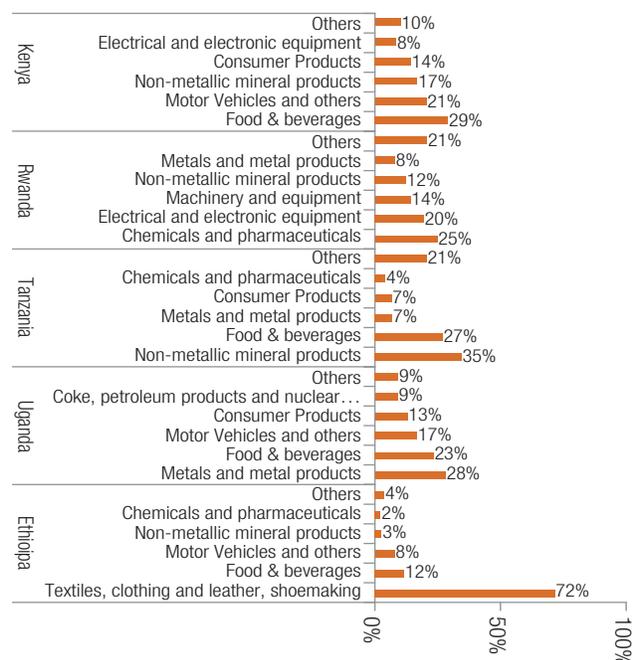
4. Greenfield Manufacturing FDI by Investor Groups, Sample Countries, 2003/14, Share of Total Investment



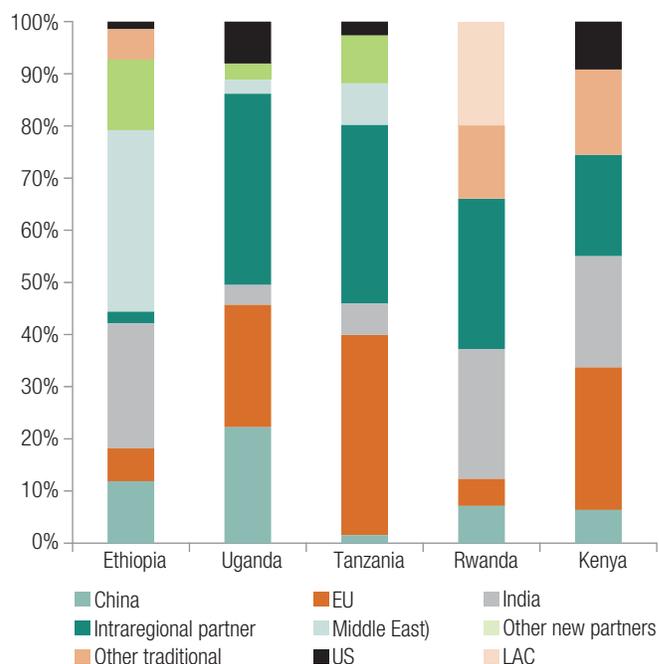
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FIGURE 3: Sectoral FDI in Selected Countries in SSA (continued)

5. Top Sectors in Manufacturing FDI for Job Creation, Greenfield Projects, 2003/14, % in Total



6. Job Creation in Manufacturing FDI by Investor Groups in Sample Countries, 2003/14, % in Total



Source: 3.1 World Development Indicator, 2014; 3.2, 3.3 Ethiopia data from EIC; Other countries are from Foreign Investor surveys conducted by respective Central Banks, various issues; 3.4–3.6 fDi Markets (www.fdimarkets.com).

TABLE 4: Greenfield Manufacturing FDI Inflows by Sub-Sector, 2003–2014, US\$M

	Ethiopia	Kenya	Rwanda	Tanzania	Uganda
Coke, petroleum products, and nuclear fuel			1,641		6,641
Food, beverages, and tobacco	1,290	456		440	385
Textiles, clothing and leather, and footwear	2,510				
Non-metallic mineral products (including building & construction materials)	546	580	165	791	260
Motor vehicles and other transport equipment	505	508		61	255
Chemicals and pharmaceuticals	264	458	65	179	
Metals and metal products	75	61		214	455
Publishing and printing		165	163		65
Consumer products		247			52
Electrical and electronic equipment		178	69		
Machinery and equipment		78	49		
Rubber and plastic products	73				

Source: fDi Markets Database (www.fdimarkets.com).

Note: Only sectors with cumulative investments more than US\$50 million are highlighted.

TABLE 5: Greenfield Manufacturing FDI of Country Origin, 2003–2014, US\$M

	China	India	EU	US	Intraregional Partner	Middle East	Other new partners	Other Traditional	LAC
Coke, petroleum products & nuclear fuel			5,000		3,282				
Food, beverages and tobacco		388	1,098	348	334	118	185	122	
Textiles, clothing and leather, footwear	580	1,226				327	215	169	
Non-metallic products (incl. construction materials)		145	393		1,712	67			
Motor vehicles and transport equipment	556	465					95	212	
Chemicals and pharmaceuticals	162	256	350					179	
Metals and metal products	161		179	61	219	191			
Publishing and printing			379						
Consumer products			273					54	
Electrical and electronic equipment								145	69
Machinery and equipment			80						
Rubber and plastic products			80						

Source: fDi Markets Database (www.fdimarkets.com).

Note: Only sectors with cumulative investments more than US\$50 million are highlighted.

economic growth and welfare improvements (Farole and Winkler, 2013).

FDI in the manufacturing sector in Africa is dominated by non-traditional sources. This is consistent with the analysis of Lin (2014). He shows that rising labor cost in China has been a major factor in driving its overseas investment in labor-intensive manufacturing. Figures 3.3 and 3.4 demonstrate respectively the major investors for overall FDI and manufacturing FDI in the five sample countries. Traditional partners accounted for large stocks in 2012–2014 for overall FDI but represent much less proportion in manufacturing FDI. In contrast, the bulk of FDI inflows to the manufacturing sector were from new partners and intraregional partners, led by

China, India, and South Africa. The major fields of investment are textile and clothing, and leather and footwear; and motor vehicles and transport equipment for both India and China in manufacturing. Besides, China focuses more on metal and metal products while India does so on food processing. South Africa's investment in the manufacturing sector is relatively small compared to that of China and India, targeting food and beverages, chemicals, and construction materials (see Table 5).

Measured by investment motivation, manufacturing FDI is mainly market-seeking in SSA. A series of occasional surveys by the central banks and investment promotion agencies all point out that most of manufacturing FDI are dominated by market-seeking

FDI. For example, in the investor survey conducted by Uganda Investment Agency in 2012, 65 percent of respondents reported that access to domestic and regional markets was the major factor that influenced their investment decisions, second only to the factor that was “favorable macroeconomic and political stability.” (Uganda Bureau of Statistics 2012).¹⁰ Also, among Greenfield projects in the countries we examine, firms are found to be mainly driven by the desire to access either directly the national market or indirectly the regional or international market through the host country. Factors influencing efficiency FDI inflows such as cost of production and skills of the labor force have been found to affect FDI decisions less (FDI Market, 2003–2014). In addition, survey results suggest that access to market will continue to be important for South-South FDI going forward.¹¹

Moreover, profitability in manufacturing generally higher compared to other sectors, likely reflecting the high risk and low competitive environment.¹² First, recent surveys show that the overall rate of return of FDI in Africa has been above 9 percent since 2006, higher than world average of 7.5 percent and developing country average of 8.1 (data for 2011). In Rwanda, manufacturing realized an average return to equity (ROE) of 24 percent in 2013. In Tanzania, net profits after tax in manufacturing increased consistently since 2008 and tripled between 2008 and 2011. Similarly, the profitability of manufacturing FDI in Uganda has been the second only to finance among all sectors in 2011–12 and 2012. These high rates of return have attracted more FDI inflows to SSA (Razafimahefa and Hamori, 2005), and also reflect the low competitive environment and high risk involved in investing in Africa.

Higher tolerance of risk seems to have supported larger increases of FDI from new partners to SSA. Investors from traditional partners are used to more supportive institutional environments, and thus most prefer to make informed decisions on investment location and strategic considerations based on thorough demanding technical evaluation, using their existing business model. This usually leads to

large-scale manufacturing investment with predicted risk under control. New partners, on the other hand, rely heavily on the channel of experimentation and the “word of mouth.” Investors from these countries are more accustomed to less supportive institutional environments, and many are more adapted entrepreneurs in high-risk environments. According to the Africa Investor Report 2011, the major information source for investment opportunities for traditional partners are “external expert” and “HQ/Parent company” channels; to new partners information comes from existing investors. These types of channels brought many small-scale, flexible manufacturing investments to Africa. In addition to existing investors, a significant number of Chinese manufacturing firms invested in SSA reported that they consulted embassies about investment opportunities—both African embassies in China and Chinese embassies in Africa.

While high rate of return helps attract FDI in manufacturing, it doesn't translate into positive benefits to host economy automatically. On the one hand, the high return on manufacturing FDI has the potential to attract increased FDI, which in turn generates value-added in host countries, creates jobs and income for workers, and contributes to GDP. On the other hand, the increase of retained earnings has been slower than that of repatriated earnings over the last few years in the sample countries.¹³ In the long run, this may have negative effects on the balance of payments of the countries since the dominated

¹⁰ Moreover, the foreign investment survey administered in Kenya indicated that more than 60 percent of the respondents in manufacturing sector recognized that access to domestic and international markets have a positive effect on their business operations. This percentage is higher than that was reported in services sector (Kenya National Bureau of Statistics, 2013).

¹¹ The World Bank/UNIDO survey of 713 potential investors from Brazil, India, South Africa and South Korea.

¹² Profitability of stockholders' investment is measured by the rate of return, which is the ratio of the net income from a business or a project to the total money invested in the venture; or return on equity, which is the ratio of the net income of a business to its stockholders' equity during a year.

¹³ See Foreign Investor Survey, Kenya National Bureau of National Statistics, 2013; Private Sector Investment Survey, Bank of Uganda, 2013; and Foreign Private Investment in Rwanda, Bank of Rwanda, 2013.

market-seeking FDI in African economies doesn't generate export revenues. Therefore a policy objective should probably be to maximize the reinvestment rate in order to accrue the FDI income to the domestic economy as much as possible and generate further productive capacity for development (UNCTAD 2012).

Manufacturing FDI has led to increased job creation among sectors in some sample SSA countries, according to recent data and studies. In Tanzania and Uganda, for example, even though manufacturing is not always the largest sector in capital investment there, it has generated the largest number of jobs in these two countries. In Tanzania, foreign investor survey reported that manufacturing was the largest job creator among sectors over the period 2008–2009, averaging 36,303 jobs per year and accounting for 43 percent of total jobs created by FDI (Bank of Tanzania, 2013). Uganda's investor survey divided jobs into full-time and part-time types, and showed that manufacturing achieved the highest job creation in 2012, both in full-time (23 percent of total) and part-time (79 percent of total) (Bank of Uganda, 2013). In Ethiopia, manufacturing accounts for 28 percent of total employment opportunities between 2008 and 2014, the largest non-agricultural sector in terms of job-creating FDI (Ethiopia Investment Commission, 2014).

Different sectors dominate different countries in terms of FDI job creation. For example, in the last decade (2003 to 2014), some emerging subsectors characterized by large employment included textile and clothing, and leather and footwear in Ethiopia. In Kenya it was food and beverage, and motor vehicles and other transport equipment. Non-metallic mineral products, and food and beverage were the main job-creating FDI sectors in Tanzania; while metal products and food and beverage led in Uganda, and chemicals and pharmaceuticals did so in Rwanda (Figure 3.5).

Available data suggest that FDI from new and intraregional partners drives employment creation in manufacturing. It is not surprising that the considerable contributions to job creation in manufacturing came from investment of new partners, since they are

currently the main source of labor-intensive subsector s in manufacturing. For example, looking at Greenfield projects between 2003 and 2014, India, China, UK, and Germany provided the most job opportunities in SSA. By investor group, total number of jobs created by new partners (e.g., China and India) or intraregional partners (e.g., South Africa and Kenya) is comparable with those provided by traditional partners (e.g., UK, U.S. and Germany) (Figure 3.6). However, the major job creator in terms of sectors within each group was different: for China and India, the majority of jobs were channeled through industries such as textiles and clothing, and leather and footwear; whereas EU group created more jobs in food and beverages, and some high-skilled sectors such as coke and petroleum products. Figures 4.1 to 4.5 show the top employers in subsector s that generated large job opportunities in the sample countries.

Unskilled jobs usually constitute large numbers of local employment created.¹⁴ Due to the fact that low-skilled¹⁵ manufacturing is dominant in the examined countries, foreign firms demand more trainable unskilled laborers than skilled ones considering the lower wages of unskilled employment (The World Bank 2012a and 2015). However, formal training remains insufficient in manufacturing firms (Figure 4.6). Moreover, the training results are below the expectation of the foreign investors. Sometimes less educated workers are unable to operate machines properly; in some cases, communication gaps resulting from language and cultural differences affect the efficiency and accuracy of training.¹⁶ Because of the limitation on the education level of workers and training capacity of firms, the quality of goods produced by trained workers is still poor and uncompetitive in the global market. This is a common issue for textile and leather factories, which adopt a “low-wage” strategy for higher profit.

¹⁴ Unskilled jobs are defined as jobs that don't provide any formal training to the workers.

¹⁵ Low-skilled manufacturing includes food and beverage, wood and wood products, and textiles, clothing and leather. See Moran 2015.

¹⁶ This is more serious for Chinese firms where English, French, or Portuguese are not the working languages.

Overall, investment climate factors have become more important to sustain FDI beyond the initial project implementation, a fact derived from empirical evidence and investors' perception. Investors, especially those from emerging countries are initially attracted by abundant natural and human

resources and market potential in SSA countries but gradually find it is not easy to survive and thrive due to some constraints. As several studies indicate (for instance (Kinda 2014; and Morisset 2001) the long-term drivers of FDI into SSA countries can be attributed to investment climate factors related to

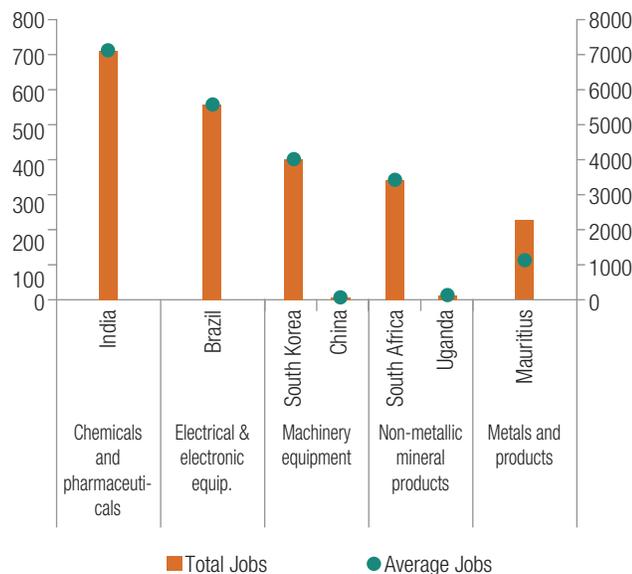
FIGURE 4: Top Investors in Sub-Sectors that have Large Job Creation, Greenfield Projects



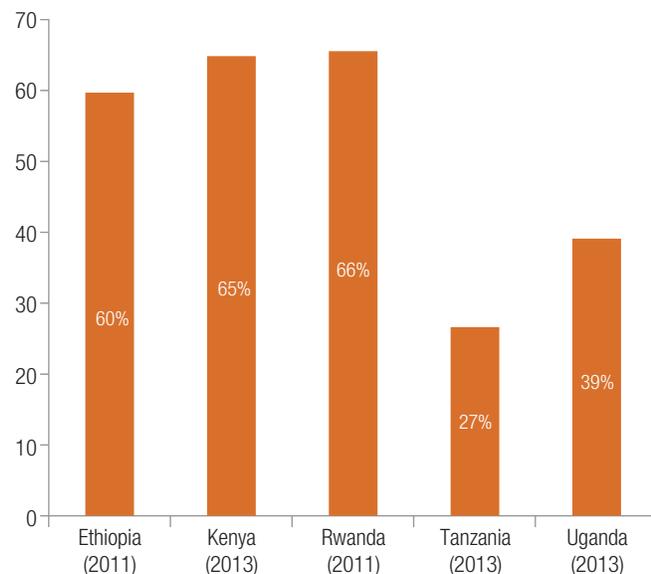
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FIGURE 4: Top Investors in Sub-Sectors that have Large Job Creation, Greenfield... (continued)

5. Top Investors in Rwanda (2003–2014)



6. Formal Training in Foreign Manufacturing Firms (% of Total)



Source: 4.1–4.5 fDi Markets (www.fdimarkets.com); 4.6: Enterprise Survey, including both foreign firms and domestic firms.

Note: 4.6: considers companies with 10 percent or more foreign ownership.

infrastructure, human capital and institutions. Less conducive investment climate can drive cost of doing business up and further offset the benefits from factor endowments. For example, on average 37 percent of the foreign manufacturing firms in the five countries identified electricity as the major constraint, resulting in the loss amounting to average 6 percent of annual sales (Enterprise Survey 2011/13). At subsector level, more serious losses happened in chemical, plastic & rubber in Kenya (7.5 percent loss of annual sales); food industry in Uganda (as high as 19.7 percent loss of annual sales); and textile and garment industry in Tanzania (7.3 percent loss of annual sales) (Enterprise Survey 2011/13). During the past five years, several Chinese textile companies in Tanzania and Uganda were forced to shut down due to the electricity problem (see Table 6 with an overview of electricity as constraint).¹⁷ Other major issues include delays at ports/airports and shortages of skilled workers (Moran 2015; Akhlaque and Buba 2015). Annex 2 compares the cost of doing business in the sample countries. With the high cost of doing business, even though

foreign investors succeed in starting their operations, they still will face challenges threaten their survival.

Increasingly, empirical evidence suggests that some labor-intensive subsectors in manufacturing are more sensitive to value chain integration (or lack thereof), particularly when it comes to the supply of production inputs. Moreover, the shortage of intermediate inputs is negatively affected by unfavorable business environment factors such as trade logistics and import tax rate. As discussed in a World Bank study on light manufacturing in Africa in 2012 there are critical input constraints in five subsectors in Ethiopia (World Bank 2012a): apparel, leather products, wood products, metal products, and agribusiness. And in fact, this is a common issue in other countries as well. In Uganda, about 14 percent (or 124) of foreign firms reported that the unreliable supply of production inputs was the main reason leading them to operate below installed production capacity in

¹⁷ See more examples in Tang 2015, page 184.

TABLE 6: Cost of Doing Business: Electricity as a Constraint

Economy	Number of electrical outages in a typical month	Losses due to electrical outages (% of annual sales)	Proportion of electricity from a generator (%)	Percent of firms owning or sharing a generator	Percent of firms identifying electricity as a major constraint
Ethiopia	7.6	5.3	27.4	86.0	46.8
Kenya	6.7	6.2	8.5	70.0	45.7
Rwanda	5.2	1.1	4.8	69.6	17.8
Tanzania	8.3	3.7	13.6	68.7	57.7
Uganda	4.9	14.2	15.6	78.3	14.8

Source: Enterprise Survey, data as of 2015.

Note: This table considers companies with 10 percent or more foreign ownership.

2012 (Uganda Bureau of Statistics, 2012). In Rwanda, access to raw materials was identified the most binding constraint for both small and large manufacturing firms in a survey of 43 representative firms¹⁸ (Gathani and Stoelinga, 2013). In Tanzania, between 2009 and 2007, only 11 percent of foreign firms chose to source more than half of their raw materials from local market, others either imported or produced locally (Bank of Tanzania, 2013). While evidence shows that Chinese investors encountered difficulties in realizing the local low-cost labor advantage due to the overly high cost of raw materials.¹⁹ This problem is crucial when comes to textile and garment industry, which

are facing supply issues of intermediate materials (e.g., ginning cotton lint). Therefore, there is a loophole of primary materials that disconnects the raw materials and finished products of the value chain, restricting the scale and speed of the manufacturing development (Tang, 2014).

¹⁸ Manufacturing firms surveyed were selected based on criteria that included, among others, a profiled turnover more than US\$1M per year, and hiring more than 30 employees.

¹⁹ For example, the cost of importing pebble material is US\$40/m³, which is almost four times the price in China. (Lu and Kweka 2013).

CASE STUDIES

Case Study 1: Ethiopia²⁰

FDI Trends

Ethiopia's economic performance has been robust, but its FDI inflows have increased only moderately over the past decade. Ethiopia is one of the fastest growing non-oil producing economies in Africa with an average growth rate of 10.7 percent per year between 2004 and 2012, almost double the SSA average of 5.4 percent over the same period. Since Ethiopia issued its first investment proclamation in 1992, an attempt has been made to use FDI as an instrument to develop the economy. However, FDI inflows to Ethiopia have struggled to grow for many years. The ratio of FDI to GDP declined to below 1 percent between 2008 and 2013, making Ethiopia the second lowest in the average FDI-to-GDP ratio among comparators.²¹ Similarly, the share of FDI to export averaged 10 percent in this period, lower than the comparators (Table 3). Recent annual data shows a significant increase in FDI, however. Ethiopia's FDI has hit a record high of US\$953 million, or about 2 percent of GDP in 2013, indicating a sign of new momentum (WDI 2015).

Within FDI flows, the conversion rate of licensed FDI projects from the “pre-implementation” phase to the “operational” phase is quite low, and it varies significantly across sectors. While some of this may be related to methodological issues, there is a real trend of decreasing operationalization. Ethiopia's official FDI data distinguishes various FDI phases from pre-implementation to operational. From 2008 to April 2014, 4,378 investment projects were registered with the Ethiopia Investment Agency.²² However, of these projects, only a small fraction (21

percent by project number or 16 percent by invested capital)²³ moved from preparation to operations. Moreover, the share of operational projects in all licensed projects declined in recent years (from 38 percent in 2008 to 18 percent in 2012) (Figures 5.1 and 5.2; Figure 5.3 shows the similar trends across sectors). Data for pre-implementation may be slightly inflated due to the ease of registering interest to invest even when no concrete investor interest persists. On the other hand it is difficult to distinguish registrations that never aimed to get operationalized and those that failed to operationalize for real reasons. However, the overall trend of low and decreasing operationalization is most likely to be intact as evidenced when only looking at declining numbers of operational FDI projects in Ethiopia across all sector (Figure 5.3).

As for manufacturing FDI, although its cumulative growth is in line with the country's development plan as described in Ethiopia's Growth and Transformation Plan (GTP), recent data indicates challenges in implementing manufacturing projects and bringing them to the operational stage (Figure 5.4). The registered projects in manufacturing

²⁰ This section is primarily based on data from the FDI database of the Ethiopia Investment Commission (EIC). EIC keeps a list of FDI projects in the form of a “three stages” classification: Pre-implementation, Implementation and Operations. According to EIC's classification, at the “pre-implementation” phase firms declare their intention to invest in Ethiopia and claim allotment of land; at “implementation” firms effectively receive the land and start construction and installation of machinery; and at “operations” phase firms are allowed to start operations. Data spot checks show that a clear distinction of projects along the three stages cannot be done and ‘double counting’ may occur. The primary analysis in this section therefore focuses on the projects under operation.

²¹ Comparators are Kenya, Tanzania, Uganda, and Rwanda as noted previously.

²² Ethiopia Investment Agency was reorganized as Ethiopia Investment Commission (EIC) in 2014.

²³ Note: The EIA (EIC) updates the status of projects regularly. Thus the discussion focuses on the status as of April 2014.

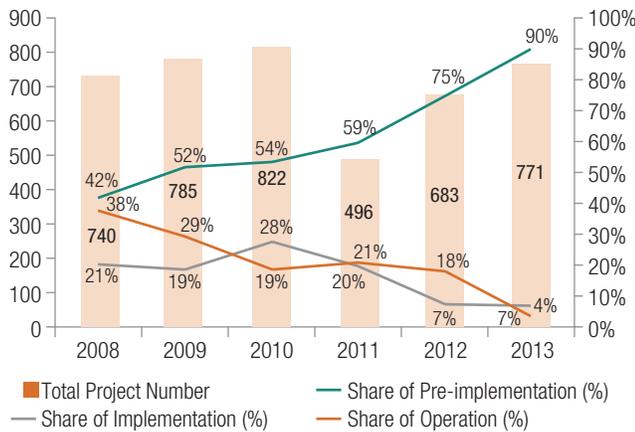
reached 1,472 cumulative over the time period from 2008 to 2013 (or about \$US8.9 billion), indicating a good level of interest by foreign investors in this sector. Compared to other sectors, the share of operational projects in manufacturing is the highest in capital investment. However, the proportion of manufacturing projects that actually started operations, after obtaining business licenses issued by EIC, was estimated at 25 percent (374 out of 1,472) from 2008 to 2013. Of these, only 4 percent (16 out of 433) commenced operations in less than one year in

2013. Even after six years, only 25 percent started operations, and the rest of projects have likely been discontinued. Therefore, the low conversion rate is a key issue that Ethiopia needs to solve in order to realize the potential benefits of FDI because significant delays may force investors to leave and adversely affect investor confidence in Ethiopia.

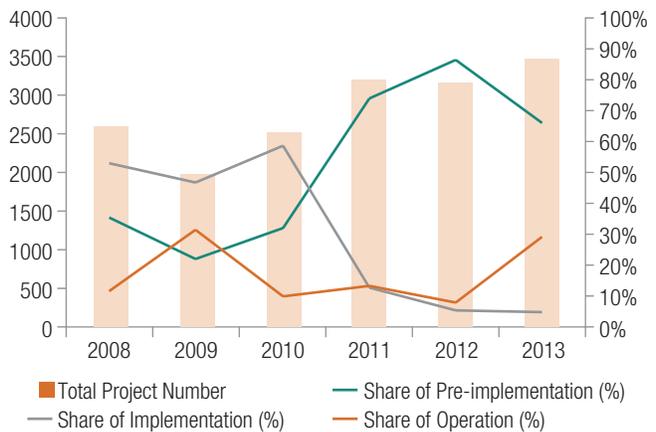
The remainder of this analysis focuses on operational projects over the period of 2008 to 2013 in order to capture the actual amount and pattern of FDI.

FIGURE 5: FDI in Ethiopia: Overall Trends

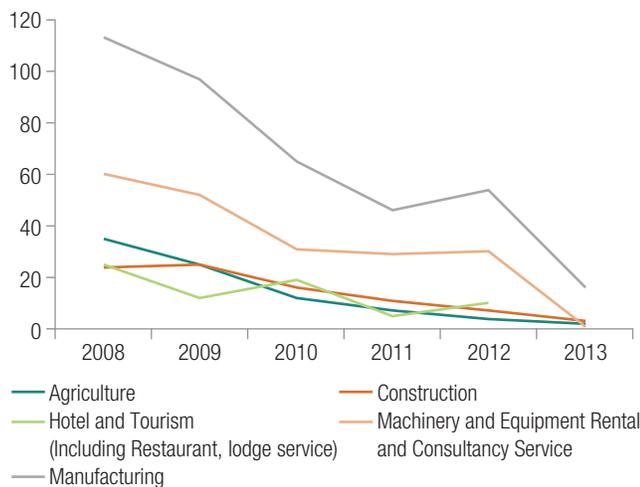
1. FDI by Number of Projects in Ethiopia, 2008–2013



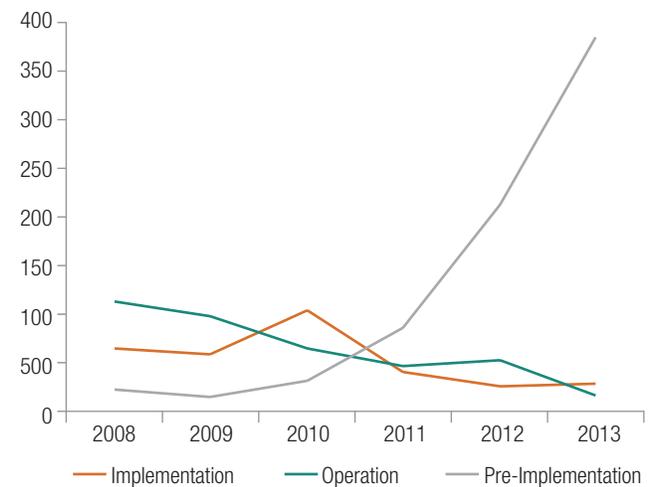
2. FDI by Capital Investment in Ethiopia, 2008–2013, US\$M



3. Trend of FDI Projects under Operation in Ethiopia, by Main Sectors, 2008–2013



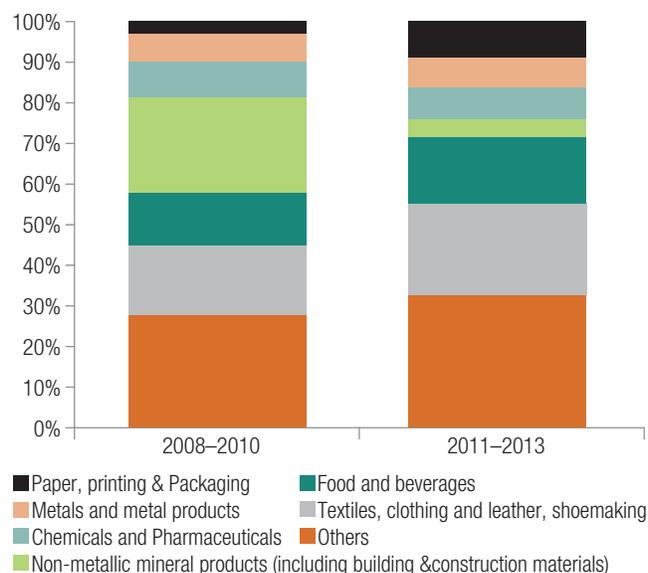
4. Trend of Manufacturing FDI by Investment Status in Ethiopia, by Project Number, Status as of 2014



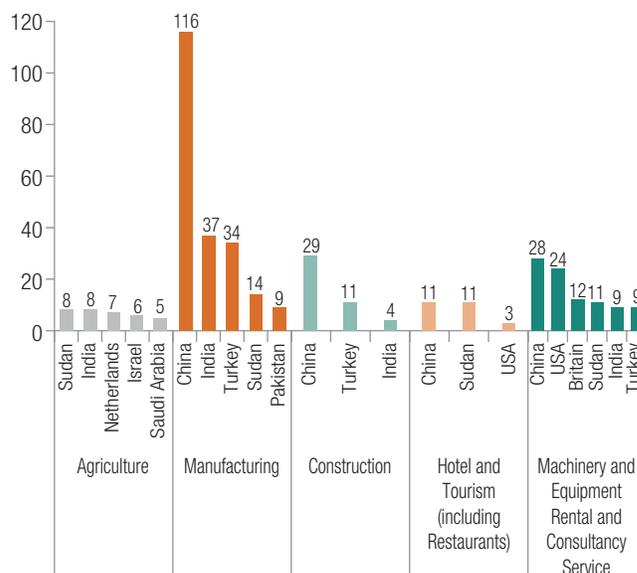
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FIGURE 5: FDI in Ethiopia: Overall Trends (continued)

5. The Sub-Sectoral Composition of Manufacturing FDI, by Project Number, 2008–2013



6. FDI in Ethiopia at Operations Stage, by Sectors & Top Investors, 2008 – April, 2014



Source: Ethiopia Investment Commission (EIC).

Note: In Figure 5.5, “Others” include rubber and plastic products, wood and wood products, electrical and electronic equipment, motor vehicles and other transport equipment, machinery and equipment, and consumer products.

The manufacturing sector was the top recipient of FDI both by number of projects and level of investment. Manufacturing accounts for the largest share at 76 percent of the total investment for operational projects, reaching US\$2.2 billion over the last six years. Moreover, the average size of manufacturing projects has been the largest, almost double than that of agriculture projects, the second largest sector in average size of project (EIC, 2014)

The FDI trend varies by subsectors in the manufacturing sector from 2008 to 2013. As Figure 5.5 shows, the composition of FDI in manufacturing sector has changed over the time. The relative weight of textile and clothing, and leather and footwear subsectors increased rapidly; and the same happened to the food and beverage subsector. Additionally, the paper, printing, and packaging subsector also increased. In comparison, nonmetallic mineral products (such as cement, concrete, and gypsum manufacturing) declined. Finally, the metal products, chemicals,

and pharmaceuticals subsectors roughly maintained the same weight. Because only projects that survived were examined, this may imply that current investment climate has favored some subsectors over others.

The majority of manufacturing FDI comes from new partners such as China, India, Turkey, and Sudan, and their average project sizes vary considerably. There were 920 operational projects in Ethiopia from 2008 to 2013, either solely owned by one country or as joint venture. By project number the top five investors are China (196 fully owned by Chinese), India (64), Turkey (57), Sudan (54) and the U.S. (45); while by capital, the top five are Turkey (US\$967 million), China (US\$545 million), Saudi Arabia (US\$279 million), India (US\$254 million) and France (US\$96 million). Among these, Turkey has the largest average project size; in contrast, Sudan’s project size is the smallest. Figure 5.6 shows the top investors across sectors. In the manufacturing sector, new partners (China, India, Turkey, and Sudan) are also

the top investors by project number, while traditional investors have limited presence because most of their investment is in services. Furthermore, traditional investors use joint ventures more often in this sector, and Netherlands, Germany, the US and Italy are the major investors in this group.

Among new partners, China and India have maintained long historical ties with Ethiopia in trade and investment, but exhibited many differences in investment patterns. Before 2008, the Chinese FDI was mainly in construction and related activities (30 percent by number of projects and 56 percent by investment since 1992) (EEA/EEPRI 2009). In comparison, the Indian FDI concentrated in cut flowers, plastic manufacturing, and water drilling. Manufacturing FDI from both countries has grown rapidly and their operational projects reached peak in 2008–2009. Over last seven years, manufacturing has attracted the lion's share of FDI from both countries. Also, China and India recorded relatively high conversion rate: both reached 30 percent. Apart from textile and clothing, leather and footwear, and nonmetallic mineral products (including building and construction materials), Chinese and Indian FDIs have shown different concentrations in manufacturing products. Chinese companies have become engaged in products such as electrical and electronic equipment and rubber and plastic products; while Indian investors focus on chemicals and pharmaceuticals, as well as paper, printing and packaging.

FDI Determinants

Market size and political and social stability have been the two major determinants for FDI in Ethiopia. There have been numerous surveys and studies investigating the determinants and types of FDI inflows to Ethiopia, and an emerging consensus is that market size and potential, a comparatively safe and less corrupt business and social environment, and a favorable temperature for agriculture are the main drivers (UNCTAD 2004). Recent survey data by fDi market²⁴ also confirmed these findings. Another survey

in 2014 also revealed that market size and potential, investment incentives and political and social stability are top three drivers for foreign investments in Ethiopia (Teka 2014).

In addition, specifically related to manufacturing FDI, low cost of labor stands out as a major driver. A survey of 45 Chinese manufacturing firms Ethiopia in 2012 shows that their good understanding of investment climate comes through through social networking, and that the low cost of labor and local market size in Ethiopia are the main reasons influencing their decision (World Bank 2012). The first reason reflects the traditional investment behavior among Chinese investors who tend to form clusters to share risks when investing overseas. As discussed earlier, information from existing investors is one critical source for new partners to make investment decisions, while the reasons represent the main characteristics of resource-seeking and market-seeking type of FDI, respectively. Similarly, India's investment has been mainly attracted to the low cost of labor and raw materials (e.g., cotton for textile, hide for leather) as well as investment incentives (Ancharaz et al. 2014).

FDI Impact and Results

Of all jobs created by FDI in Ethiopia, the manufacturing sector has created the most permanent jobs over the last five years. Based on data from the Ethiopia Investment Commission, at first glance FDI in agriculture seems to employ 54 percent of the workforce, while manufacturing is second only to agriculture, employing 28 percent of the total from 2008 to April 2014 (Figure 6.1). However, the bulk of jobs in agriculture are temporary. In contrast, manufacturing created more permanent jobs. In fact, if only permanent jobs are examined, manufacturing becomes the top job creator, accounting for 60 percent of the total permanent jobs created (Figure 6.2).

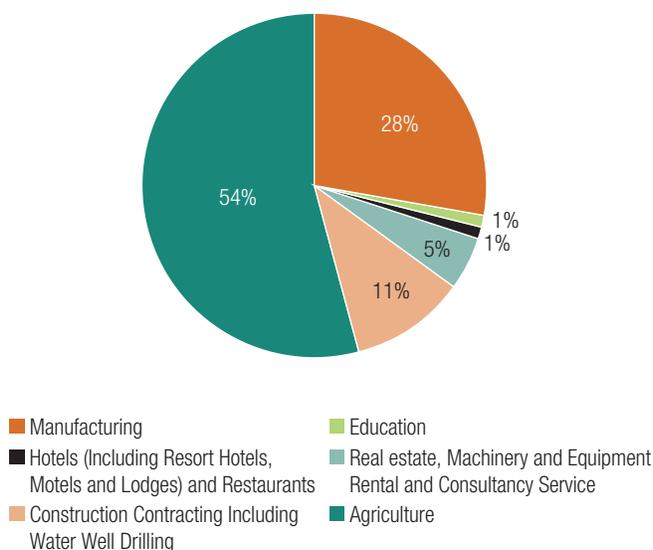
²⁴ According to the fDi Markets database, the key reasons for investment were regulations or business climate, domestic market growth potential, and natural resources, in that order. The motives for investment were cited by companies for 20 projects.

While FDI from new partners has created the most manufacturing jobs, they are concentrated in low-skill sectors. Textiles and clothing, and leather and footwear; construction-related manufacturing; and food and beverage are sectors that hold the largest employment (Figure 6.3). China (24 percent of total

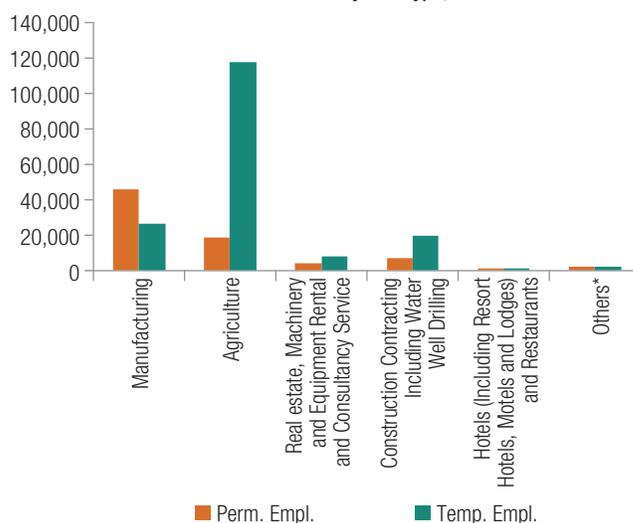
jobs), Turkey (22 percent) and India (6 percent) are the top three job creators in the manufacturing sector both for permanent and temporary type of jobs from 2008 to 2014, creating more than half of the total employment, in which 70 percent are permanent jobs (Figure 6.4). Moreover, their job creation

FIGURE 6: FDI in Ethiopia: Employment Trends

1. Employment Opportunities Created at Operations Stage by Sector, 2008–2014

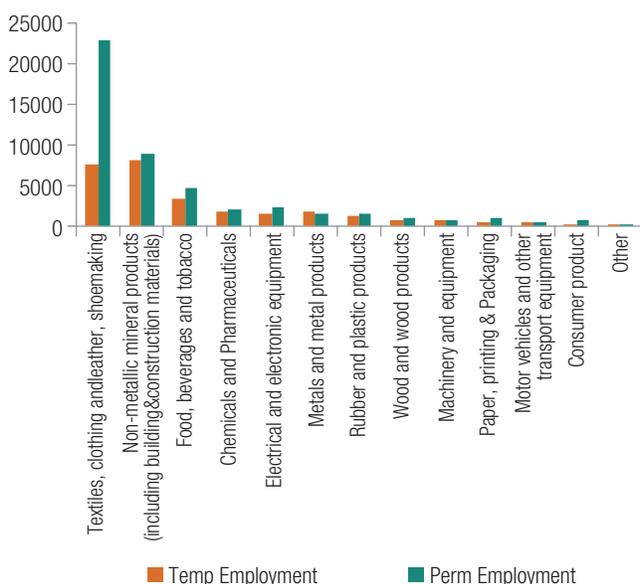


2. Sectoral Contribution to Job Creation by Job Type, 2008–2014



* Others includes Mining, Tour Operation, Transport and Communication, Education, etc.

3. Top Sub-Sectors in Manufacturing FDI for Job Creation, Ethiopia, 2008–2014



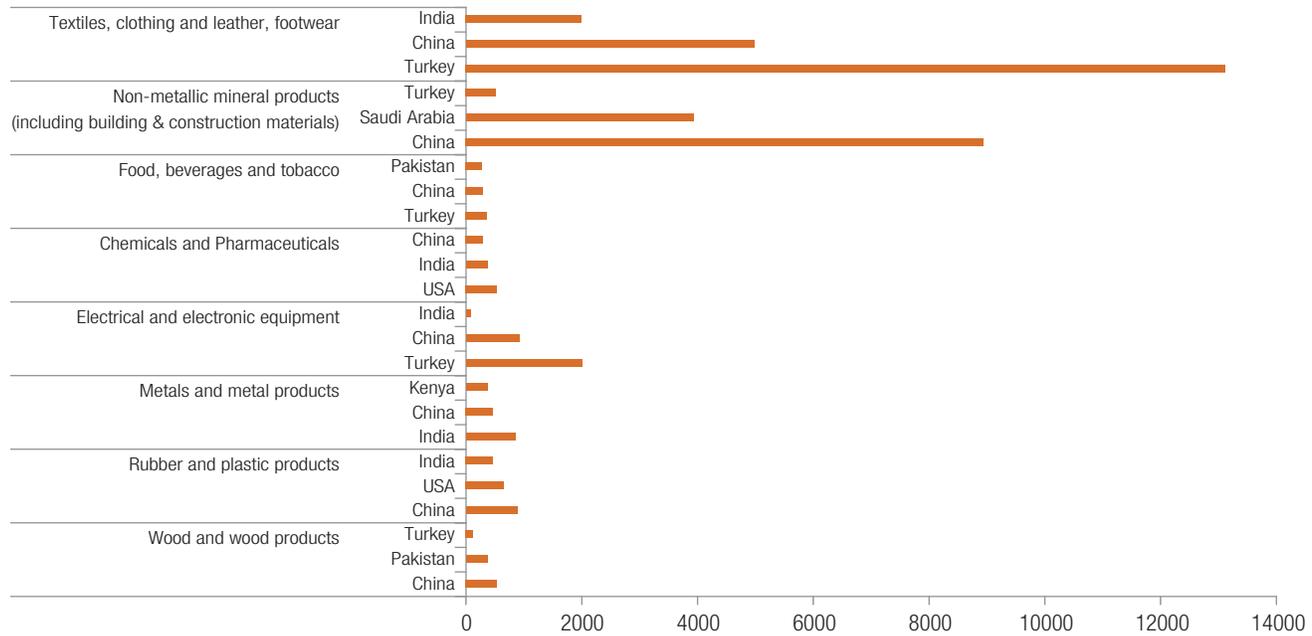
4. Top Investors in Manufacturing FDI for Job Creation, Ethiopia, 2008–2014



(continued on next page)

FIGURE 6: FDI in Ethiopia: Employment Trends (continued)

5. Top Investors in Sub-Sectors that have Large Job Creation, 2008–2014, Ethiopia



Source: 6.1–6.5 Ethiopia Investment Commission (EIC).

record differs by subsector (Figure 6.5). For example, Chinese FDI tends to create major job opportunities in construction-related manufacturing, such as non-metallic mineral products including steel products, cement, and gypsum products, while Turkish and Indian FDI firms hire workers for textiles, clothing and leather, and footwear subsectors.

Recent evidence in Ethiopia also suggests that resource-seeking and market-seeking FDI can be converted or upgraded to efficiency-seeking when such FDI matures under a supportive business environment. Although Ethiopia is dominated by market-seeking (e.g., food processing such as Diageo Brewery or chemical such as Unilever) and resource-seeking (for securing cheap labor and raw input) type of FDI, some evidence proves that efficiency-seeking FDI is emerging in textile sector and leather sector. In the textile subsector, Indian firms have fostered value-addition by investing in products such as cotton yarn that generate additional value for export (Ancharaz et al. 2014). Some value-added products

are vertically integrated into the supply chain. For example, Indian investors have invested about US\$50 million in processing hide by establishing tanneries while at the same time purchasing leather through local sourcing. Similar evidence is emerging in the cotton-textile-apparel value chain. Moreover, increased labor productivity ensures these foreign investors can integrate advantages of the factor endowment and policy incentives into efficiency-enhancing operations. For example, Hua Jian, a Chinese footwear firm has relocated its factory to Ethiopia to take advantage of the low cost of labor and preferential access to the U.S. and EU market, but over time the consolidation of these two factors has resulted in some productivity advantages, which would also classify their operations as efficiency-seeking.

Investment climate factors are shown to significantly affect FDI operations in Ethiopia. As shown in the literature survey, FDI requires a combination of factors in host countries, such as infrastructure facilities plus a skilled workforce. Firm-level data in

Ethiopia show that insufficient infrastructure, poor trade logistics, and a lack of skilled labor are currently the key constraints for FDI in Ethiopia (World Bank 2015a; Akhlaque and Buba 2015). These issues may seriously undermine investors' confidence, and some may choose to discontinue their investment preparation. Specifically, the utility problem already adversely affected potential investment decisions in the Eastern Industry Zone.²⁵ In addition, many small manufacturing FDI firms adopt the "foot-loose" model, where manufacturers put a premium on the ability to move quickly from one country to another (Tang, 2014). Therefore, they are sensitive to the cost of labor and investment incentives in the host country. As a result, the registration and preparation process is often an experiment to find the most suitable location to invest. As such, the low rate of conversion from the registered projects suggest that some discouraged investors would likely have withdrawn after initial setbacks, indicating that improving investor care in some priority sectors is an urgent task to support FDI in Ethiopia.

Policy measures can help attract more FDI and improve its impact. In the short-term, effective investment promotion (e.g., one-stop-shop service, aftercare, etc.) and incentives (e.g., tax holiday, import duty free, etc.) can serve to attract more manufacturing firms and facilitate the operationalization of projects. In the long-term, for the sustainable development, the Ethiopian government should focus more on supporting infrastructure, streamlining trade logistics and addressing the shortage of skilled human resources. Therefore, at this point, newly designed policies may be first piloted in the Special Economic Zones as an experiment to be implemented nationwide in the long term.²⁶

Case Study 2: Rwanda

FDI Trends

FDI to Rwanda has gained momentum over the last five years, albeit is still on a low level. Real GDP growth in Rwanda has been high over the past

decade, averaging about 8 percent since 2004. From a low basis, FDI per capita increased almost 15 times in Rwanda when comparing the periods 2002/05 with 2010/13 (see Table 3). Between 2008 and 2013, a total of 280 investment projects, either fully owned by foreign investors or in the form of joint ventures, were registered with the Rwanda Development Board. The accompanied capital investment has increased significantly, reaching a high of US\$258 million in 2013, up from US\$103 million in 2009. Still, FDI inflows as a share of GDP remain low. In fact, the ratio fell to 1.5 percent in 2013 after a peak of 4.5 percent in 2010. Moreover, compared to the other 31 landlocked countries in the world, Rwanda's FDI to GDP ratio is about average, making it the 21st landlocked country in FDI inflows over the period 2011–2013 (World Bank, 2015).

Manufacturing has been the third largest sector in attracting FDI in Rwanda, consistent with supportive government policies towards this sector. From a national perspective, a blend of policies have been formulated and implemented in supporting the development of manufacturing sector.²⁷ According to the National Bank of Rwanda, manufacturing accounts for the third largest share (19 percent) of the total FDI stock as of 2013, after ICT (41 percent) and the financial sector (20 percent) (Figure 7.1). Also, FDI inflows in manufacturing increased steadily by about 2.6 times per year; investment in the ICT sector varied significantly over the years, from a dramatic spike in 2011 to US\$167 million down to US\$20 million in 2013; investments in the financial sector experienced a moderate growth, averaging at US\$29 million per year (Figure 7.2). Overall, however, manufacturing

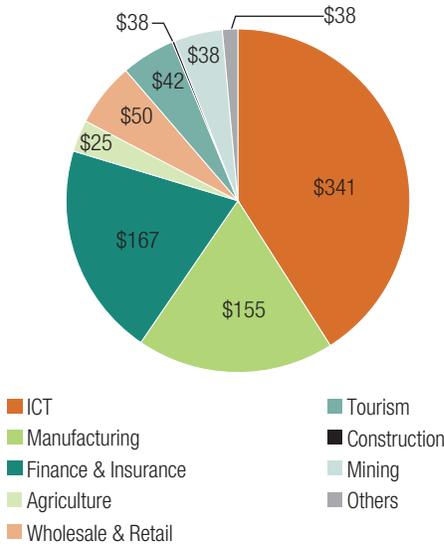
²⁵ Interview with Eastern Industry Zone Operator, November 2014.

²⁶ See Lin (2013) for details.

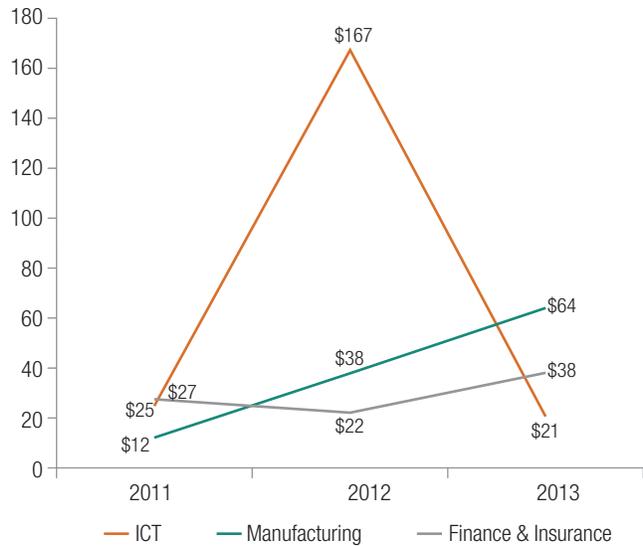
²⁷ For example, in the second phase of the Economic Development Poverty Reduction Strategy (EDPRS II), Rwanda placed manufacturing as a critical sector to ensure economic transformation. Targets were formulated in this respect, aiming to have the industrial sector (manufacturing, construction and mining) contribute 20 percent to GDP by 2018. Moreover, in the Rwanda Private Sector Development Strategy (PSDS), there is an entire pillar that aims at building a more competitive manufacturing sector by adopting new technologies, improved quality and deepening value chains; all aspects in which FDI can play a crucial role.

FIGURE 7: FDI in Rwanda

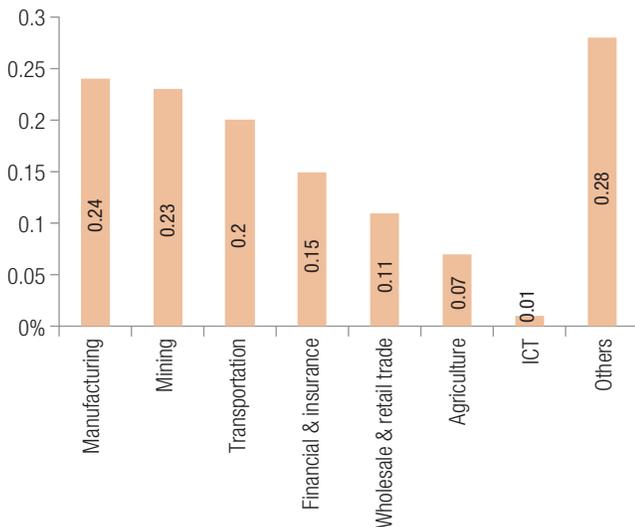
1. FDI Stocks in Rwanda, End 2013, US\$M



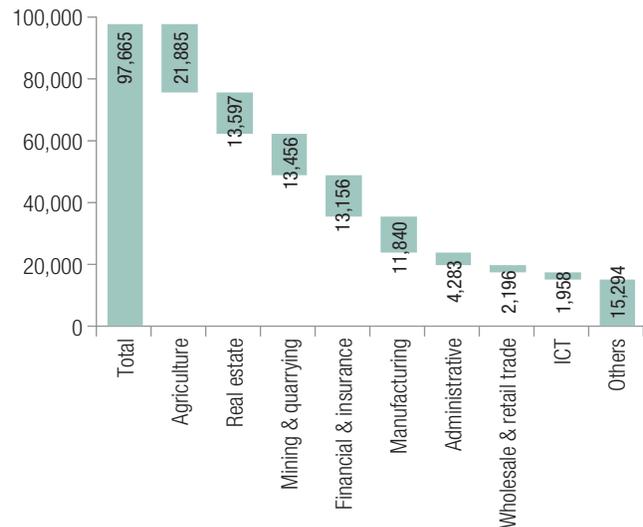
2. FDI Inflows in Main Sectors of FDI in Rwanda, 2011–2013, US\$M



3. Return on Equity by Sector in 2013, Rwanda



4. Distribution of Job Creation by Sector in Rwanda, 2011–2013, Cumulative



Source: Foreign Private Investment in Rwanda, National Bank of Rwanda (2013).

contributed only 0.3 percent to the average annual GDP growth rate of 7.1 percent (2009–2014), lagging behind the services (4.0 percent) and the agriculture sector (1.6 percent).

The construction materials and agro-processing subsectors dominate manufacturing FDI, mainly due to local availability of raw materials and the booming construction sector. Light manufacturing,

among others, is developing particularly in the subsectors of construction materials (such as cement and steel products), food processing, and dairy and beverages (AfDB 2014). Construction material is the largest and fastest growing component of Rwanda’s manufacturing sector, representing 51 percent of recent investments in the manufacturing sector (National Bank of Rwanda 2013). In the food processing subsector, a few

foreign firms account for the majority of market share: Bakhresa Group (from Tanzania) is the largest wheat flour producer; Bralirwa (from The Netherlands) is the largest brewer and soft beverage company (Gathani and Stoelinga 2013).

The bulk of manufacturing FDI in Rwanda has been market-seeking. Although Rwanda has a relatively small domestic market, the market potential is quite significant due to the Common Market for East and Southern Africa (COMESA), East African Community (EAC), and the African Growth and Opportunity Act (AGOA) market, all of which offer quota- and duty-free market access. This view is supported by surveys carried out through fDi Markets on the motives for 32 Greenfield projects between 2003 and 2014. The key reasons for investors to choose Rwanda as destination were proximity to markets or customers (43.8 percent), regulations or business climate (25 percent) and domestic market growth potential (21.9 percent). Infrastructure and logistics, skilled workforce, and natural resources were only cited by 3 percent of companies as the reason for the investment decision, respectively. In contrast, efficiency-seeking manufacturing investment in Rwanda has been relatively low, as investment in the main subsectors of construction materials and food-processing still target for domestic consumption and preferential access to the EAC region and DRC.²⁸

Traditional investors and African investors provide the two major sources of manufacturing FDI. The principal foreign investors are from South Africa, Mauritius,²⁹ Kenya, Uganda, The Netherlands, and Switzerland. Intra-African investment has been the largest source for manufacturing FDI in Rwanda, representing respective 84 percent and 54 percent of investment in capital and the number of Greenfield FDI projects respectively. The investment are more diversified and across all the subsector groups. Traditional investors are very active in the light manufacturing and agro-processing sectors, especially in the tea, coffee, and alcoholic beverages sectors (Gathani and Stoelinga 2013). Except for South Africa, other BRICS countries' (Brazil, India, China, and South

Africa) presence in Rwanda is still limited. This is partly because China and India investors are attracted to the development potential in the ICT sector in Rwanda: both of their largest investments of FDI were in the ICT sector.³⁰

FDI Determinants

A rising domestic market owed to good economic performance has been a cornerstone of Rwanda's relative success in attracting FDI. Rwanda is one of the fastest growing economies in Africa with a growth rate averaging at 7.7 percent between 2004 and 2013. Empirical evidence suggests that economic success in Rwanda is an effective determinant for attracting FDI. Using time series data covering the period of 1971 to 2003, Surge et al. (2008) conclude that economic growth has a significantly positive impact on foreign direct investment (FDI) inflows in Rwanda. In addition, because country risk ratings are reported to have a high correlation to actual future equity returns (Harvey et al. 1996), political and social stability since the late 1990s also plays an important role when the investors make their decision to invest in Rwanda.

Access to regional and global markets is a critical economic determinant of market-seeking FDI inflows to Rwanda. This advantage has been strengthened by Rwanda's trade policy reform. Rwanda has an open trade regime. It is a member of the World Trade Organization and of several sub-regional economic organizations, such as East African Community (EAC),³¹ Common Market for East and

²⁸ On average, between 2008 and 2010, 53 percent of manufactured exports went to the DRC, 23 percent to Burundi, 8 percent to Kenya, 3 percent to Uganda, 1 percent to Tanzania and another 1 percent to other destinations (Gathani and Stoelinga 2012).

²⁹ Mauritius is among the large investor countries due to the fact it hosts most of holding companies even though the ultimate controlling companies are not based in Mauritius. Historically, Indian FDI tends to be channeled through Mauritius.

³⁰ China's largest deal is Star Communication Network Technologies in terms of amount; India's is Bharti Airtel.

³¹ The members of EAC include Burundi, Kenya, Rwanda, Uganda, and Tanzania.

Southern Africa (COMESA),³² and the Economic Community of the Great Lakes (CEPGL).³³ These regional organizations have allowed foreign investors in Rwanda to have easier access to the larger regional market. Moreover, the country enjoys the preferential access to EU (through the Everything But Arms Initiative), and to the U.S. (through the Africa Growth and Opportunities Act and the Generalized System of Preferences). In addition, Rwanda has several bilateral treaties with some individual countries such as China, Malaysia, and South Africa. Through the active cooperation in the fields of cross-border trade, Rwanda's ranking in trading across border as a dimension of doing business indicator leaped from 169th in 2010 to 31th in 2014. Empirical evidence shows that trade openness has exhibited positive impact in attracting FDI in Rwanda (Surge et al. 2008).

In addition to promising markets, good investment climate factors play a role for Rwanda in attracting FDI. As mentioned earlier, countries whose policies are conducive to foreign investment activities stand a better chance of attracting FDI. This is a crucial reason why Rwanda, as a small, land-locked, non-resource-rich country, is able to attract sizeable levels of FDI. The Government has made the attraction of investment a key policy priority and therefore established the Rwanda Development Board in 2009 as a one-stop shop supporting private sector development through investment and export promotion. It takes only six hours to register a new business irrespective of the initial capital requirement (\$250,000 for foreign investors), making Rwanda one of the most straightforward countries for business registration. Rwanda also has good reputation for fighting corruption. The high-profile anti-corruption effort led by the government plays an important role in attracting FDI.

Rwanda has a relatively high operational rate of FDI projects compared to Ethiopia. Between 2009 and 2013, of the 280 registered FDI projects in Rwanda, more than half (54 percent) are operational and 25 percent (or 69 projects) are in the pre-implementation phase. Only 14 percent or 38 projects are still committed to starting their activities. To compare:

the previous case study on Ethiopia showed that only 21 percent of projects there moved from preparation to operation. The Government of Rwanda undertook a number of key reforms targeted at the implementation of investment projects, including aftercare services and better trade logistics.

The establishment of aftercare services, some of which especially target manufacturing FDI supports implementation of investment projects in Rwanda. The Rwanda Development Board functions as “one-stop shop” with delegated authority from various government agencies. It provides a full range of investment-related facilitation services including business plan evaluation, securing required approvals, and certificates, and obtaining building, construction, and work permits. Specifically for manufacturing, the manufacturing development division in the Rwanda Development Board offers aftercare services so as to facilitate investors in implementation and operation of their investment projects and also address binding constraints through policy advocacy.

By adopting an ambitious Trade Logistics and Distribution Services Strategy, Rwanda has made consistent progress in reducing the heavy logistics and transport costs and facilitating exports. The OECD Trade Facilitation Indicators (TFIs), and the World Bank Logistics Performance Index (LPI) have reported improved trade logistics indicators over the past five to seven years.³⁴ Recently, the Government has undertaken several proactive steps to reduce the average time taken to import or export goods both in

³² This organization includes Rwanda, Burundi, Comoros, DRC, Djibouti, Egypt, Ethiopia, Kenya, Libya, Madagascar, Malawi, Mauritius, Seychelles, Sudan, Swaziland, Uganda, and Zimbabwe.

³³ Members are Rwanda, DRC, and Burundi.

³⁴ TFIs reveal that Rwanda performs better than the average SSA countries in the areas of information availability, streamlining procedures, governance, and impartiality; LPI indicates that Rwanda outperformed the average SSA countries in all six dimensions. As for overall LPI score, Rwanda ranks 80th out of 160 economies surveyed. The six dimensions include: 1) efficiency of the clearance process, including customs; 2) quality of trade and transport related infrastructure (e.g., ports, railroads, roads, information technology); 3) ease of arranging competitively priced shipments; 4) competence and quality of logistics services (e.g., transport operators, customs brokers); 5) ability to track and trace consignments; and 6) timeliness of shipments.

transit countries and at the port of entry.³⁵ Through streamlining border procedures and reducing the number of documentation requirements, it is expected to reduce the time to clear goods by three days, which will lead to direct savings for business estimated to be US\$6–9 million per year (Permanent Mission of Rwanda to the UN 2014). Finally, Rwanda is aiming to establish industrial zones to avail serviced land and facilitate quick project operationalization.

FDI Impact and Results

FDI accounts for a large share of total manufacturing output and realized the highest profitability across sectors. In a sample of Rwanda's 47 largest construction materials and agribusiness firms, it is estimated that firms that are either fully owned by foreign capital or in which foreign investors hold a majority stake accounted for about 70 percent of the total output in 2011, with an estimated aggregate output of US\$280–290 million (Gathani and Stoelinga 2013). Among the sectors, manufacturing realized the highest profit in 2013, with a ROE of 24 percent (Figure 7.3). Given these measures in output

and profitability, it is likely that foreign-invested firms have performed better and grown faster than domestic firms. This is further proven by some cases in which foreign investors took over domestic firms that had run into financial difficulty and returned the firms to profitability (Gathani and Stoelinga 2013).

Average job creation in Rwanda is relatively low, a reflection of more FDI directed to ICT and financial services. Over the period 2009–2013, the 280 registered FDI projects created a total of 34,580 jobs. Most of the employment generated by FDI was still in the agriculture sector; jobs created by manufacturing FDI only account for 12 percent of the total (Figure 7.4). This result corroborates with the survey conducted among the largest manufacturing firms in 2013 that total employment corresponds to just 0.34 percent of Rwanda's labor force (Gathani and Stoelinga 2013).

³⁵ Measures include developing an e-government portal to improve information availability; implementing Electronic Single Window System (ESWS) that allows all parties involved in trade and transport to document information with a single entry point, to name a few; See details in Trade Facilitation and Transit Transport, speech by the permanent mission of Rwanda to the United Nations, New York, June 2014.

SUMMARY AND RECOMMENDATIONS

Summary

Africa has lagged behind in industrialization; the lack of industrial development has been partially related to the challenge of attracting sufficient foreign direct investment (FDI). In 2013, the average share of manufacturing value added in GDP in Sub-Saharan Africa was 11 percent, almost unchanged from the 1990s. At the same time, the share of the worldwide FDI flows into SSA has been rather low during the same period. In the *Action Plan for the Accelerated Industrial Development of Africa (AIDA)* that were adopted by all the member governments of the African Union in January 2008, the importance of manufacturing development was reiterated and attracting foreign investment was identified as the major priority for the acceleration of Africa's industrialization.

Compared to the past, FDI into Africa is relatively high and more diverse than ever before. FDI flows into SSA have expanded almost six-fold since 2000, reaching a record US\$45 billion and leading to a significantly higher FDI stock (US\$474 billion) in 2013. Still, FDI into Africa is only a fraction of world FDI flows. The more diversified nature manifests in several dimensions: *First*, FDI into Africa is slowly shifting from extractive sectors to services and manufacturing sectors. *Second*, FDI reached a larger geographic scope over the past five years, with increasing shares received by Southern and Eastern Africa. *Third*, there is a significant increase of South-South FDI, including that from new partners led by China, India, and Brazil, and intraregional partners led by South Africa. Manufacturing FDI reflects similar diversification patterns and some African countries such as Ethiopia are building up their manufacturing bases by attracting FDI from new partners.

FDI has proven useful in the past to advance economic development and foster structural change in host countries. Recent literature and empirical evidence suggests due consideration is needed from policy makers to maximize benefits of FDI, such as skills and technological transfer, and foster overall spillover effects to the domestic economy. These arguments are strongly supported by the practical experiences of East Asian Tigers and of China, where FDI contributed significantly to upgrading and diversification of its industrial structure. A wide variety of policies to maintain macroeconomic stability, increase trade openness, and accelerate the growth of advanced industries were implemented. The evaluation is assumed to vary depending on country, sector, and the motivation of FDI that can be.

Manufacturing FDI in SSA is primarily market-seeking. There are three types—resource-seeking, market-seeking and efficiency-seeking—when looking at FDI in Africa. Manufacturing FDI in SSA is mainly market-seeking and its main determinants are market size and market potential. In addition, political and economic stability are important factors considered by foreign manufacturers when they choose the investment location. On the other hand, efficiency-seeking FDI, observed at firm level, is the smaller part of manufacturing FDI in Africa since only a handful of foreign companies are able to take advantage of lower production cost in some manufacturing areas only, such as textile and clothing, and leather and footwear.

Manufacturing FDI in Africa remains relatively undiversified, focusing on raw material (food) processing or end-product assembly, which are characterized by low value addition, even in those countries that manage to attract significant inflows. In addition, some manufacturing production areas are more successful in attracting foreign investors

than others. Those areas differ by host countries. For example, in the last decade, some emerging subsectors included textile and clothing, and leather and footwear in Ethiopia; non-metallic mineral products and motor vehicles and other transport equipment in Kenya; metal products and non-metallic mineral products in Tanzania; metal products and non-metallic mineral products in Uganda; and non-metallic mineral products and publishing and printing in Rwanda. In addition, FDI is traditionally concentrated in the food and beverage subsector in most of the countries.

Non-traditional sources dominate FDI in Africa. New partners and African partners have been the main sources of manufacturing FDI. Traditional sources of manufacturing FDI are shrinking but still account for large stocks. The share of investment from China and India increased rapidly, gradually taking over the proportion of investment originating from the EU and the U.S. Intraregional investment continued to soar and largely contributed to the rebound of Africa FDI to the pre-crisis level.

While FDI into Africa generally tends to have relatively high returns of investments, likely reflecting the high risk and low competition environment, profitability in manufacturing is generally even higher compared to other sectors. Recent evidence shows that the overall rate of return of FDI in Africa has been above 9 percent since 2006, higher than the world average of 7.5 percent and developing country average of 8.1 (data for 2011). On the other hand, in Rwanda, manufacturing realized an average return to equity of 24 percent in 2013. This result also partly explains what drives manufacturing FDI from new partners into SSA. Investors from emerging countries are more accustomed to less supportive institutional environment, and many are more adapted entrepreneurs in high-risk environments.

Manufacturing FDI creates more jobs than FDI in any other sector. Manufacturing has led in job creation among sectors in the reviewed SSA countries such as Tanzania, Uganda and Ethiopia. According to the most recent FDI data (2013/14), the manufacturing sector in Tanzania accounted for 43 percent of

total jobs created, three times more than jobs created in agriculture. Manufacturing FDI also achieved the largest job creation in Uganda in 2012, amounting to 30 percent of the total FDI-driven jobs. Similar patterns are also recognizable in Ethiopia, especially in terms of permanent employment creation. A significant portion of employment opportunities in manufacturing is attributed to non-traditional investors. However, formal training remains insufficient in manufacturing firms.

Unstable supply of inputs and uncertainty of time required for transport and logistics build a binding constraint for manufacturing FDI in Africa. Drawing from empirical evidence and investors' perception, some binding constraints are identified as critical to further improve the performance of manufacturing FDI. The dependence on imported production inputs, erratic electricity supply, and poor trade logistics drive the cost up and pose the threat to the sustainability of FDI. These bottlenecks also lead to production inefficiencies that constrains Africa's integration into the global value chain.

The Ethiopian and Rwandan case studies suggest that the regulatory business climate is attractive for FDI and contributes to the rate of project operationalization. For many manufacturers who are increasingly looking for new destinations to maintain lower cost for their labor-intensive industries, the registration and preparation process is often an experiment to find the most suitable location in which to invest. As such, the low rate of conversion to operability in Ethiopia from the registered projects suggests that some discouraged investors had likely withdrawn after initial setbacks, indicating that improving investor care in some priority sectors is an urgent task to support FDI.

Recommendations

This report offers five policy recommendations that could contribute to the attraction of manufacturing FDI in Africa. To further the benefits of FDI, especially in the manufacturing sector, policymakers in Africa would need to pay close attention to FDI flows and trends, especially from emerging (new) partners.

First, manage FDI flows and FDI-related policies in a way that maximizes spillovers in host countries. FDI can bring both benefits and costs to host countries, which suggests that FDI needs to be managed actively to maximize benefits. Common definitions of FDI emphasize its long-term character and the fact that FDI carries a controlling ownership with the enterprises in the host country. Nevertheless, there are also potential drawbacks to FDI, including a deterioration of the balance of payments as profits are repatriated, a lack of positive linkages with local communities, and a lack of absorptive capacity for taking advantage of FDI spillover effects. Policy makers can increase the absorptive capacity by, for instance, pursuing investment policies that aim to close technology gap, by increasing human capital through better and more education services, and by establishing sound competition policies.

Second, realize the emergence of FDI from new partners, especially in manufacturing FDI, and establish platforms that help in the attraction of new FDI. While FDI in Africa is at historic levels, only a few countries have received significant increases in manufacturing FDI, which is again led by new partners. Only six countries in SSA received the large majority of manufacturing FDI between 2011 and 2014. To seize the opportunity and attract FDI for the development of the manufacturing sector due consideration and attention needs to be put on the policies and activities of emerging (new) partners. This analysis showed that the major information source for potential new partners comes from existing investors. Creating channels and fora for information exchange between existing and prospective investors, possibly through embassies and investment promotion agencies, seems thus to be a good way to attract investment from new partners.

Third, increase investment in key infrastructure to overcome constraints for manufacturing activities to develop, especially in power supply and transportation and logistics services. Overall, investment climate factors have become more important to sustain FDI beyond the initial project

implementation, a fact derived from empirical evidence and investors' perception. Investors, especially those from emerging countries, are initially attracted by abundant natural and human resources and market potential in SSA countries, but gradually find it is not easy to survive and thrive due to some constraints. With the high cost of doing business, even though foreign investors succeed in starting their operations, they will often still face challenges to sustain operations. Overcoming key constraints, be it infrastructure or policy-related is therefore critical to ensure a high operationalization of FDI in Africa.

Fourth, take better advantage of the currently dominating market-seeking manufacturing FDI to improve the weak industry base in the short-term. Market-seeking FDI has a sizeable positive contribution to the host economy, but the depth of the positive spillovers depends again on the absorptive capacity of the host economy. Competition policies are important to strike a balance between avoiding crowding out of local firms and policies that restrict foreign entry. Likewise, the strength of intellectual property rights in a host country has an impact on the quality of foreign investment that can be attracted, and therefore the potential for FDI spillovers.

Fifth, strengthen the linkages between domestic material input and foreign manufacturing investment. Increasingly, empirical evidence suggests that some labor-intensive subsectors in manufacturing are more sensitive to value chain integration (or lack thereof), particularly when it comes to the supply of production inputs. Strengthening the absorptive capacity of the host economy is instrumental (again) to connect local companies to foreign ones. Lowering the technological gap and increasing human capital are instrumental; more specifically, however, are also such concrete issues such as the ability of domestic firms to engage in scale production and the location of those companies compared to foreign ones. Industrial parks can play a role in this regard and pursuing their establishment could be a suitable complement to existing investment policies (see for the case of Ethiopia: World Bank 2015b).

ANNEXES

Annex 1: Data Definition

Drawing from the definition of several studies, the paper considers that New Partners are those that come from emerging countries. This group consists of BRIC countries (Brazil, Russia, India, and China); Intraregional Partners (or African Partners, African countries led by South Africa); and others (including Malaysia, Turkey, and Saudi Arabia).

Traditional Partners are those that are member countries of the OECD Development Assistance Committee. These include Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Korea, Luxembourg, Netherlands,

New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom, and the United States. Others include Bulgaria, Croatia, Republic of Cyprus, Czech Republic, Estonia, Finland, France, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia, and Slovenia.

The analysis uses data from fDi Markets, a cross-sectional project-level database compiled and operated by the Financial Times that tracks data on cross-border Greenfield investments. In addition to fDi Markets, the analysis of case studies is complemented by data from investment promotion agencies, and by information from foreign investment surveys conducted by Central Banks.

Annex 2: Cost of Doing Business in Selected Countries

	Country	Ethiopia	Kenya	Rwanda	Tanzania	Uganda
Starting a Business	Number of Procedures	9	10	8	9	15
	Time (days)	15	30	6.5	26	32
	Cost (% of income per capita)	89.3	42.7	52.3	23.8	64.4
Dealing with Construction Permits	Procedures (number)	7	8	10	18	15
	Time (days)	125	125	77	205	154
	Cost (% of warehouse value)	3.2	9.3	4.1	8.1	11.7
Getting Electricity	Procedures (number)	4	6	4	4	6
	Time (days)	95	158	34	109	132
	Cost (% of income per capita, US\$)	1,676.6	1,020.2	3,073.9	1,453.0	11,004.9
Registering Property	Procedures (number)	10	9	3	8	11
	Time (days)	41	72	32	67	43
	Cost (% of property value)	2.1	4.3	0.1	4.5	2.6
Getting Credit	Strength of legal rights index (0–12)	3	7	11	5	6
	Credit registry coverage (% of adults)	0.2	0	2.4	0	0
	Credit bureau coverage (% of adults)	0	4.9	15.7	0.6	4.9
Paying Taxes	Payments (number per year)	30	30	17	49	31
	Time (hours per year)	306	201.5	107	181	209
	Profit tax (%)	26.2	30.8	26.3	20.7	25.2
	Labor tax and contributions (%)	4.8	1.9	5.6	17.5	11.3
	Other taxes (%)	0.8	5.4	1.5	6.2	0.1
	Total tax rate (% profit)	31.8	38.1	33.5	44.3	36.5
Trading Across Borders	Documents to export (number)	8	8	7	7	7
	Time to export (days)	44	26	26	18	28
	Cost to export (US\$ per container)	2,380.0	2,255.0	3,245.0	1,090.0	2,800.0
	Documents to import (number)	11	9	9	11	10
	Time to import (days)	44	26	27	26	31
	Cost to import (US\$ per container)	2,960.0	2,350.0	4,990.0	1,615.0	3,375.0
Enforcing Contracts	Time (days)	530	465	230	515	490
	Cost (% of claim)	15.2	47.2	82.7	14.3	31.3
	Procedures (number)	38	44	23	38	38

Source: The World Bank, Doing Business, 2015.

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1818 H Street, NW
Washington, DC 20433