AFRICA FIRST?

- What can African cities do to attract more and better-suited FDI?

EVT 25 - 23 November at 14:30 to 17:30pm at Exhibition venue

Summary of the key findings and methodology

Background

The current report follows three earlier State of African Cities reports produced by UN-Habitat in 2008, 2010 and 2014. The 2008 report was a benchmarking exercise reviewing urban and housing conditions in Africa. The 2010 report delved deeper into the challenges of urban management shortfalls, poverty and mushrooming urban informal settlements (slums). Problematic access to urban land was identified and analyzed as one of the many aspects of deep poverty and socio-economic inequality in Africa. The 2014 report focused on the social, economic, political, environmental and other transformation unfolding in Africa.

This fourth report in UN-Habitat’s State of African Cities series parallels the Addis Ababa Action Plan of Financing by seeking to outline how Africa can consider financing its development strategy through foreign direct investment (FDI) in African cities. A common trait today is Africa’s massive investment gap in domestic and urban economies, infrastructure and human resources. The report argues that African nations should search for the best trajectories for their own development, considering their country and city-specific locational advantages and disadvantages in attracting more and more equitable international investments from public and private sources. This should be done with the overarching goal of accelerating Africa’s structural transformation – a large scale shift from growth dominated by the primary sector, to one led by manufacturing, service and knowledge-intensive industries.

Methodology

The research conducted for this report has made a start by analyzing the determinants that define Africa’s current position regarding the global foreign direct investment flows. In line with Africa’s targets of structural transformation and shifting labour out of low-value activities, the report critically considers the benefits of FDI into job-rich and higher-productivity sectors such as IT and manufacturing compared to agriculture and capital-intensive sectors, such as the resources sector.

The report consists of three sections:
Part A concerns general analyses and focuses on various aspects of FDI in Africa: structure, trends, forecasts, competitiveness, economic diversity, determinants and impact. Throughout Part A, attention is paid to the policy-sensitive implications for African countries and cities.

Part B, through thematic studies, looks in more detail at FDI. In the printed version we examine income inequality, employment and food security; and in the extended online version, there are also studies on labour costs, knowledge-based industries, infrastructure, real estate, policy instruments, green competitiveness and smart cities.

Part C explores the FDI profiles of four African cities: Johannesburg and Cairo as Africa’s main FDI attracting agglomerations and investment gateways into the continent; and Abidjan and Kigali as much smaller but dynamic emerging FDI-attracting cities. The overall aim of this section is to analyze how and to what extent public policies can make cities more attractive investment destinations, and how to use FDI for improving economic development.

Key findings

1. Cities perform a quintessential role in Africa’s evolving structural transformation because urban environments facilitate growth in critical economic sectors. Cities can accommodate industries that have already demonstrated sustained economic growth from 2003 to 2016, a trend which is anticipated to continue. African cities can boost their economies by positioning themselves as desirable destinations for multinational firms’ headquarters, suboffices and other activities, and thereby become important nodes in corporate strategies. The role of African cities and urbanization must reverberate in the long-term economic, spatial and demographic planning of the continent.

2. Urban economic development can lift millions out of poverty, as it has done in East Asia over the past three decades, with African cities becoming hubs of productivity that accelerate economic growth and general well-being. For this to happen, African cities need to seize a more prominent position in the world economy, by enhancing their accessibility, connectivity, markets and urban attractiveness. They also need to rapidly build workers’ skills and productive capacity, available knowledge and technology levels, as well as inclusive institutional and business capacity. FDI can serve as an important means to kick-start this, as FDI is now an important source of finance, and represents roughly a third of foreign financial sources flowing into the continent. Key aims should be to facilitate urban employment and poverty reduction, to decrease the proliferation of urban informal settlements (slums) and to secure critical urban food, water and energy supplies. Furthermore, in the context of food security, Africa’s urban revolution will arguably have to run parallel to an agricultural revolution.
3. FDI is neither a panacea, nor the ultimate answer to Africa’s development, since it has both positive and less helpful effects. Commonly recognized negative aspects of FDI in developing economies are its potential for crowding-out local businesses; its tendency to be consumption and not production driven; the fact that it is generally directed towards production for non-African markets; and its adverse effect on wage inequality and the development of indigenous skills in certain sectors. Therefore, careful choices should be made by cities in their pursuit of new and additional FDI, towards inclusive economic growth.

Analysis of FDI into Africa

FDI structure
Western Europe is the largest investor in Africa, followed by Asia and then North America. There are four major urban FDI destinations in Africa: Cairo in Northern Africa, Lagos in Western Africa, Johannesburg in Southern Africa and Nairobi in Eastern Africa. Only a few African cities e.g. Cairo, Lagos and Johannesburg, hold the financial power to also be sources of FDI (outward investors), that is, there are firms with headquarters in these cities that invest abroad, either within or beyond Africa.

FDI trends
Africa has the second highest exponential growth of inward FDI among world regions and is clearly an emerging global FDI destination. However, evidence of negative investment growth in Northern Africa (commonly perceived as the best performing region) puts African FDI growth into perspective. Of the four aggregate industrial sectors explored in this report (i.e. manufacturing, services, hi-tech and resources), FDI in hi-tech and manufacturing offers both superior FDI growth rates and the highest number of direct jobs. In many cases, these flows of FDI have reduced income inequality and generated jobs. Hi-tech has the highest FDI growth rate, while manufacturing FDI has the largest share of investment in Africa. Manufacturing FDI is currently the most important in terms of employment generation. Both sectors are shown to reduce income inequality, if local skills (absorptive capacity) and institutional qualities are adequately in place. The primary sector (agriculture and resource extraction) has shown negative FDI growth rates throughout the African continent.

FDI forecast
- Overall, FDI growth in African countries and regions is likely to continue over the next few years, although it is uncertain whether this growth will be sustainable. Attracting FDI in manufacturing, service, hi-tech and knowledge industries should complement and enhance investments in agriculture and extractive industries. This means investing in cities that promote investment growth sectors like ICT, food, real estate and healthcare, which have done particularly well.
- In Western Africa, manufacturing and hi-tech are experiencing the highest growth rates and, indeed, FDI has already reduced wage inequality in this region. Manufacturing will
attract the most FDI in the coming years. Nigeria and Cote d’Ivoire will particularly see growth.

- In Eastern Africa, service investments will see the highest growth rates.
- Northern Africa can expect stability of inward FDI. Services will replace manufacturing as the most important activity for attracting FDI in this region. Egypt and Morocco will keep their frontline position in attracting investment and regional economic growth.
- The economic development of Central Africa remains modest in the foreseeable future. Inward FDI in manufacturing and services is projected to remain at current levels, while inward FDI in resources will continue to decline. Rwanda, straddling Central and Eastern Africa, is projected to experience rapid growth and is an example of best practice in the region.

Determinants of FDI to African cities

- Inward FDI into Africa correlates positively with large urban populations (markets), trade openness, mobile phone subscriptions, internet bandwidth and full electricity supply, amongst other factors. Multinational firms seek cities and countries that sustain large populations, good standards of living, sound financial markets, and competition in terms of producing and marketing exclusive products. The case studies of Cairo and Johannesburg show that urban agglomeration is significant in attracting FDI. Large urban concentrations, with a diversified workforce, provide the competences that multinational firms seek. That is particularly important for knowledge-based FDI.
- It is also shown that African capital cities hold an advantage over other cities, due to their above-average skilled workforces and technological readiness, coupled with adequate administration (i.e. land use rights), and the availability of relevant information (government agencies, interest groups, firms). These factors combined with high-quality ICT and lower transaction costs enhance FDI attraction for multinationals.
- Such firms are attracted to destinations with large domestic markets because these provide higher returns on investment, through a more efficient use of resources. Furthermore, these destinations generally perform better in terms of gender parity across industrial sectors. Compared to other continents, women in Africa are underrepresented in formal sectors that are anticipated to become highly significant.
- A further determinant for inward FDI is the trustworthiness of public authorities and associated civic stability and institutional safeguarding of investor interests (such as the enforcement of property rights).
- Access to local credit is similarly important for attracting FDI because it strengthens private sector initiatives.

Impacts of the FDI

- All FDI sectors have a positive impact on gross national income (GNI) per capita, except the resources sector. This shows that public authorities can foster higher GNI per capita by accommodating inward FDI in manufacturing, services and hi-tech.
• An often-overlooked impact area is inequality in income distribution. Our studies show that FDI’s impact on wage inequality is mediated through local conditions such as the human capacity to absorb new technology, the availability of human capital, the presence of local technology, and the quality of governmental and private institutions.

• At the sectoral level, hi-tech and manufacturing FDI are shown to be the most important in reducing income inequality, while resources and services FDI do not have a significant impact. This means that cities will only experience a decrease in income inequality, when locally available technological skills are strengthened, adequate ICT infrastructure is provided, a robust and reliable electricity network is in place, and good-quality local firms are available.

• Manufacturing FDI is shown to be the most important sector for employment generation, since it generates the highest number of direct jobs. Consequently, attracting and generating manufacturing jobs is crucial for the economic transformation of Africa.

I addition to introducing the above key findings and methodology of the State of African Cities 2018 report summarized above, the session EVT 25 panel discussion will agree on a set of top recommendations for city, national, sub-regional and at the African continental levels on attracting more and better-suited FDI.