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FOREIGN DIRECT INVESTMENT IN LDCs: LESSONS LEARNED FROM THE DECADE 2001–2010, AND THE WAY FORWARD

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The views expressed are those of the author and do not necessarily reflect the views of UNCTAD.

Excellencies, Distinguished delegates and guests, Ladies and Gentlemen,

I am honoured to have the opportunity to make a few remarks at the start of our discussions today on Investment in LDCs. I will restrict myself to highlighting a few of the key points discussed in depth in our dedicated report launched especially on the occasion of this Conference.

Following the format of the report, I will first give you a brief overview of FDI trends in LDCs over the past decade since the adoption of the Brussels Plan of Action. I will then list some of the challenges that LDCs still face in attracting FDI, and I will outline a proposed Plan of Action for Investment in LDCs.

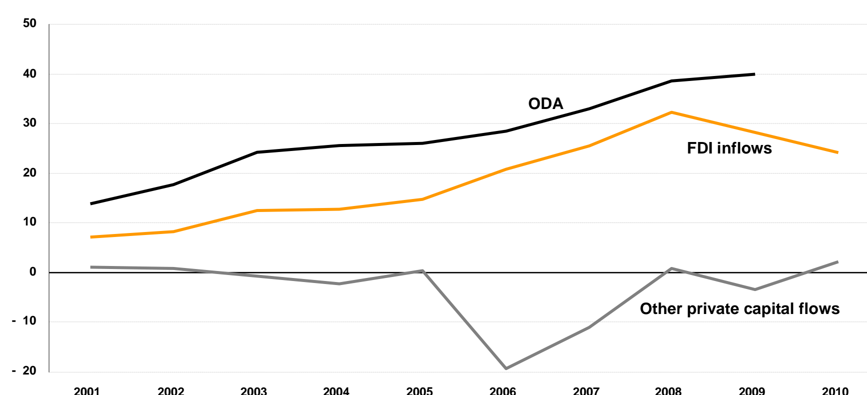
First, the trends.

FDI flows to LDCs as a group grew at an annual rate of 15 per cent during the last decade, increasing their share in global FDI flows from less than 1 per cent to over 2 per cent. However, 2009 and 2010 saw a reversal in this trend. FDI in LDCs fell by 12 per cent in 2009 to $28 billion, and again in 2010 by 14 per cent to $24 billion, as a consequence of the global financial crisis.

FDI inflows are the most important external private capital source for LDCs, exceeding foreign portfolio and other investments combined, and are nearly as important to LDCs as total ODA.

FDI is a major source of external finance for LDCs

Flows of external finance, by source, 2001-2010
$ Billions

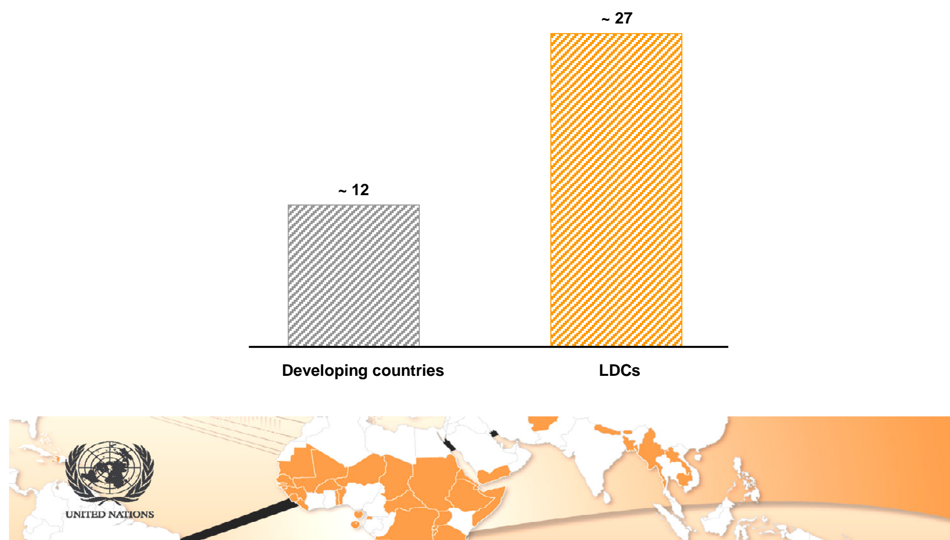


The current lack of a post-crisis FDI recovery in LDCs is a matter of concern, as FDI is a major contributor to LDCs' capital formation – much

more so than in higher-income developing countries. The share of FDI in capital formation is very high in the case of African LDCs, especially so in certain countries (e.g. Angola 63 per cent, Madagascar 65 per cent, Niger 43 per cent).

FDI makes up a significant part of capital formation in LDCs

FDI inflows as a share of GFCF, LDCs and Developing Countries, average 2005-2009
Per cent

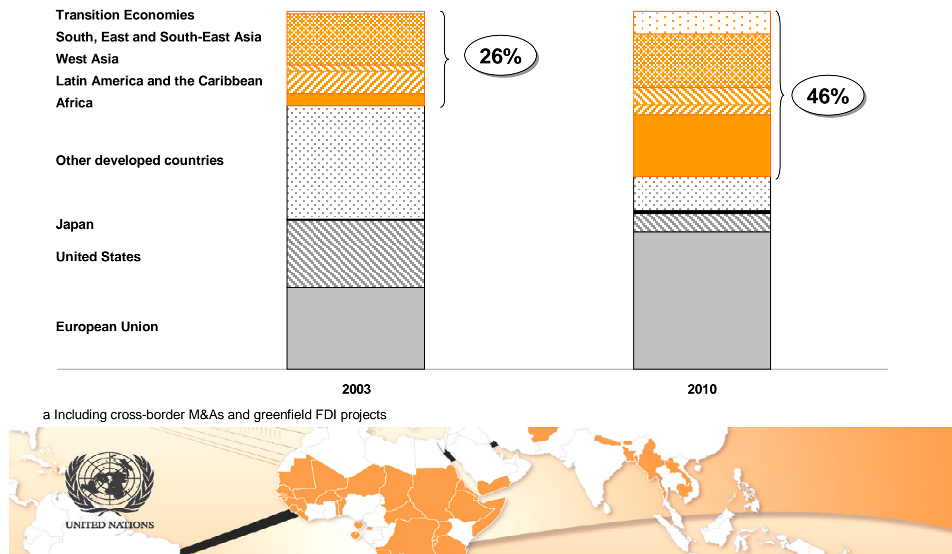


Looking at the sources of FDI flows to LDCs, the EU is still the largest investor, but the share of developing and transition economies is rising, accounting for nearly half the total of FDI projects in greenfield and M&As in 2010, compared with only a quarter in 2003. In some countries, such as Cambodia and Laos, developing countries account for more than 70 per cent of inward FDI stock. The past decade has seen substantial shifts in FDI patterns worldwide, with the emergence of FDI from developing economies. The trend is likely to persist, especially in LDCs. At the very least, this widens the pool of potential sources of investment for development for LDCs.

Increasing FDI from developing and transition economies provides LDCs with more opportunities to tap investment

FDI projects[a] in LDCs, by source country or region, 2003 and 2010

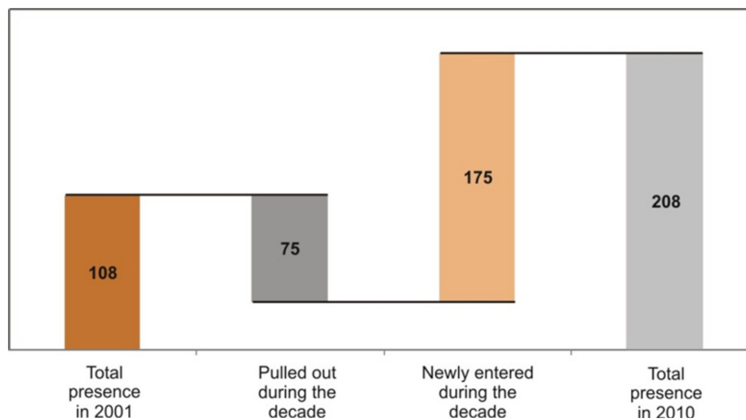
Per cent



The significant increase in FDI flows to LDCs until 2008, on the back of economic reforms and a rise in world commodity prices, is clearly reflected in the expanding presence of the Fortune 500 companies. However, the turnover of investors is relatively high. As you can see in the chart, LDCs gained 175 subsidiaries of Fortune 500 firms, but they also lost 75. It is thus important to understand not only what can be done to increase the attractiveness of LDCs for new investments, but also what should be done to retain businesses and ensure their sustainability.

The turnover in the presence of TNCs in LDCs is often significant

Presence of Fortune Global 500 firms in LDCs, variation between 2001 and 2010



Let us have a look at some of the key challenges.

First among those is the concentration of FDI in extractive industries, resulting in the fact that over 80 per cent of flows (in value terms) went to a few resource-rich economies in Africa. Such investment, although naturally positive for development, generally has a relatively weak impact on employment generation. Also, it does little to ameliorate the commodity dependence of some LDCs, and can exacerbate the existing unbalanced structure of local economies and vulnerability to external shocks.

With relatively little FDI in other manufacturing sectors, LDCs often remain at the margin of global value chains. There are, of course, exceptions. Some LDCs have succeeded in attracting more diverse forms of FDI. Foreign investments in telecommunication, banking, agriculture, tourism, food and beverages, commerce and other services abound. They are frequently underestimated, in part as a result of their limited scale. Also, the "pull-out rate" is relatively high, as seen before.

The key constraints that remain are:

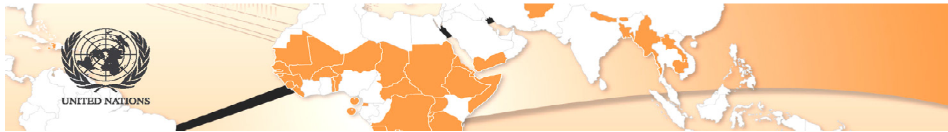
(1) Poor physical infrastructure. This hinders diversified types of FDI more than extractive-industry FDI, which often includes dedicated infrastructure investments to overcome the obstacle.

(2) A lack of productive capacities, in the form of skills and technology and in terms of a basic presence of local enterprise for supporting services and as suppliers. These problems limit LDCs' ability to reap the benefits of economic globalization and they lead to enclave investments with limited local business linkages. (We have some experience here, as UNCTAD’s Business Linkages programme has proven to be a useful tool in the establishment of business linkages between FDI and domestic small and medium-sized enterprises, in projects undertaken in Mozambique, Uganda, the United Republic of Tanzania, and Zambia, during the last three years.)

That brings me to our proposed Plan of Action for Investment in LDCs for the coming decade.

UNCTAD's proposed Plan of Action for Investment in LDCs

An integrated policy approach to investment, technical capacity-building and enterprise development



Our Plan of Action builds on the reforms and efforts that have been undertaken over the past decade, but strives to offer some new approaches. The emphasis is on an integrated policy approach to investment, technical capacity-building and enterprise development. The plan calls for steps to be taken by all the key stakeholders involved – governments in LDCs, development partners and home countries of TNCs – and it envisages a clear role for the private sector itself.

The recommendations are built around five critical areas for action.

- First: strengthen public–private infrastructure development efforts.

  Neither LDC governments, nor development partners or the private sector alone will ever be able to provide solutions single-handedly. We envisage a new partnership for infrastructure development in LDCs, increasing PPP infrastructure investments.

  LDCs need to pursue careful liberalization of infrastructure sectors and establish stable regulatory frameworks, including PPP legislation for key sectors, in particular electricity, telecommunications, transport and water.

  Development partners should consider the establishment of an LDC infrastructure development fund specifically aimed at supporting public–private infrastructure development projects, including promotion of PPPs and provision of risk insurance to private investors.

- Second: boost aid for productive capacity.

Shortfalls in terms of skills and human capital are at least as big a constraint to development in LDCs as poor roads, railways or electricity networks, and as in the case of physical infrastructure, call for a higher degree of coordination and mutually reinforcing efforts among the key players.

A partnership to build skills for productive capacities requires increased investments in technical and vocational training by Governments, and active collaboration by the private sector with technical and vocational education and training (TVET).

Development partners should consider setting up an aid-for-productive capacity fund, boosting the share of 'aid for trade' directed towards this goal (we could call it 'Aid for Investment'), and specifically aimed at supporting TVET and entrepreneurship in LDCs.

- Third: enable firms of all sizes to capture LDC opportunities.

  Large TNCs frequently bypass investment opportunities in LDCs where markets are typically small and operating conditions are more challenging. However, LDCs offer significant untapped business opportunities for nimble and innovative investors as well as potential for high returns on investment. Governments in LDCs should step up efforts to encourage small- and medium-scale international investors to tap into under-exploited business opportunities and contribute to economic diversification and cluster development. They need proactively to promote SME-FDI, including from nearby or neighbouring countries. They also should set priorities and focus policy reforms on areas where leapfrogging opportunities exist, such as in telecoms or renewable energy.

  Development partners could support these efforts by establishing risk coverage institutions dedicated to SME-FDI and coordination mechanisms between export promotion agencies in developed countries and IPAs in LDCs.

- Fourth: foster local business and ease access to finance.

  Efficient and dynamic local businesses are particularly important for efficiency-seeking foreign investors, which LDCs need to attract on a much larger scale and on a sustainable basis if they are to integrate into global value chains.

  A number of initiatives should be considered, including the establishment of credit guarantee schemes to support lending to micro, small and medium-sized enterprises and strengthening the role of development banks, as well as easing SME access to bank lending.

Development partners could support the development of a financial infrastructure in LDCs through technical assistance, and by encouraging private investors and international financial institutions to help. They could play a catalytic role in building local financial infrastructure in LDCs as part of their long-term market development strategies.

- Fifth: start the next wave of regulatory and institutional reforms.

  Although significant reforms have been carried out in LDCs over the past ten years, much remains to be done. Governments in LDCs should implement a new wave of regulatory reforms, making the strengthening of institutions and public services a priority.

  In addition, LDCs could put in place well-defined policies for priority sectors in order to provide supportive measures for investors and set a clear context and guiding principles for investment.

  Furthermore, they should build client-oriented IPAs, even though many in LDCs still have regulatory functions as part of their mandate

  LDC partners should strengthen technical assistance on key regulatory issues, encourage twinning of regulatory institutions in developed and middle-income economies with their peers in LDCs and adopt home-country measures to support LDCs, including in their fight against tax avoidance by TNCs.

Excellencies, Distinguished delegates and guests, Ladies and Gentlemen,

I have highlighted only the key points of our proposed Action Plan for Investment in LDCs. I realize, of course, that the devil is always in the detail. Some of that detail can be found in our report. Nevertheless, I hope these brief highlights will be a useful starting point for our discussion over lunch today.

I thank you for your attention.