III Trade and Investment Integration in Sub-Saharan Africa

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I Introduction

Regional integration in sub-Saharan Africa is not a recent phenomenon. At least two unions, the Southern African Customs Union (SACU) and the East African Community (EAC) have existed since 1910 and 1919, respectively. However, the majority of the regional economic integration schemes were established in the 1970s. There are currently ten such schemes and the revival of the EAC is being pursued seriously.

The motivations behind the establishment of regional integration schemes in sub-Saharan Africa (SSA) have been both political and economic. Most schemes were formed as a result of disillusionment with international political and economic systems that were viewed as unfavourable to developing countries. Some, such as the EAC and those in the CFA zone, were formed at the instigation of the former colonizers with the view of maintaining closer links across countries under their rule.

The formation of most of the unions also coincided with the era of export pessimism. This school of thought argued that the world trading system was not favourable to developing countries as a result of declining commodity terms of trade against those countries' exports, export earnings instability, low trade elasticities and unfair protectionism against their exports in developed countries. These arguments led to the conclusion that free trade could not promote development in developing countries and were used to justify import substitution-industrialisation policies and regional trading arrangements based on trade preferences.

A substantial literature on regional integration schemes in SSA exists. Recent studies include World Bank (1991), Mansoor and Inotai (1991), Lipumba and Kasekende (1991), Ariyo and Raheem (1991), de la Torre and Kelly (1992), Foroutan (1993), OECD (1993), de Melo and Panagariya (1993), and Lyakurwa et al. (1995). All these studies point to the fact that

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the implementation of these schemes has been minimal and intra-regional trade flows have been insignificant, overall less than 5 per cent of total trade flows.

It is not surprising that despite strong political appeal, regional integration in Africa has achieved very little (de Melo et al., 1993; Foroutan, 1993; Elbadawi, 1995; Lyakurwa, 1995). Many of the regional schemes were designed without regard for the incentives of the contracting parties (Fine and Yeo, 1994) and in particular without compensation arrangements in cases where benefits were likely to be unevenly distributed. It has further been argued (Mistry, 1995) that adopting a framework of cooperation inappropriate to economic realities is a certain recipe for subsequent failure. Elbadawi (1995) reports on preliminary estimates of a gravity model and concludes that regional integration has been a failure. Lyakurwa (1995), using similar methodology, concludes that although intra-SADC trade flows have been low, there is significant trade potential within the Southern African Development Community (SADC); and with the participation of South Africa, SADC is a viable trade bloc as the results of the econometric estimates indicate.

Despite the failures, the glamour of regional integration in SSA has not diminished. It is hoped that, with a population of about half a billion people, SSA forms a potentially large market if only per capita incomes could be raised. It is evident, however, that the region has been experiencing economic decline since the 1970s (see Figure 1). Moreover, with the economy

Figure 1 Trends in Average GDP Growth and Average Secondary School Enrollment Growth

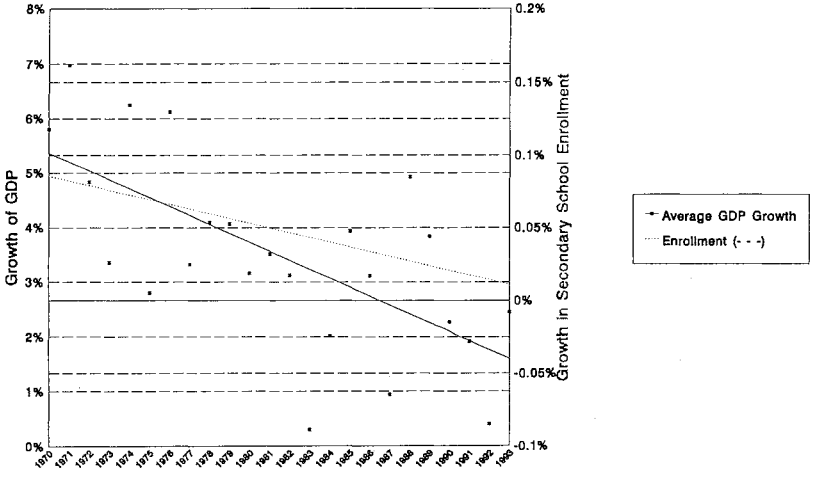

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Figure 2 Manufactured Exports to GDP and Foreign Direct Investment to GDP

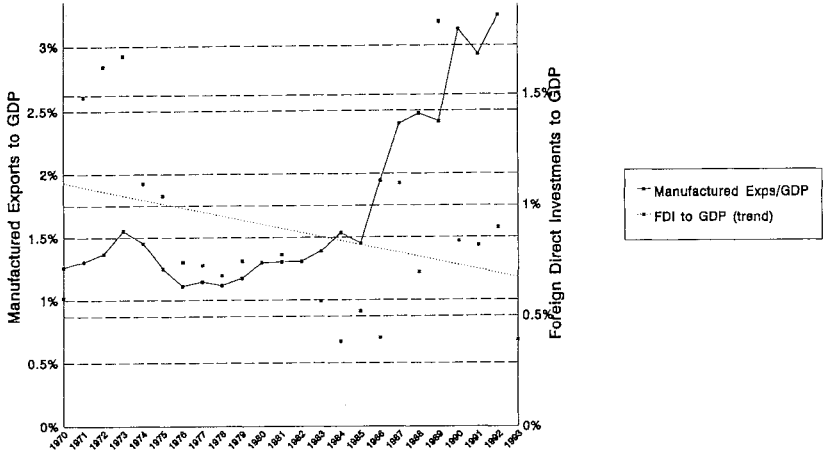
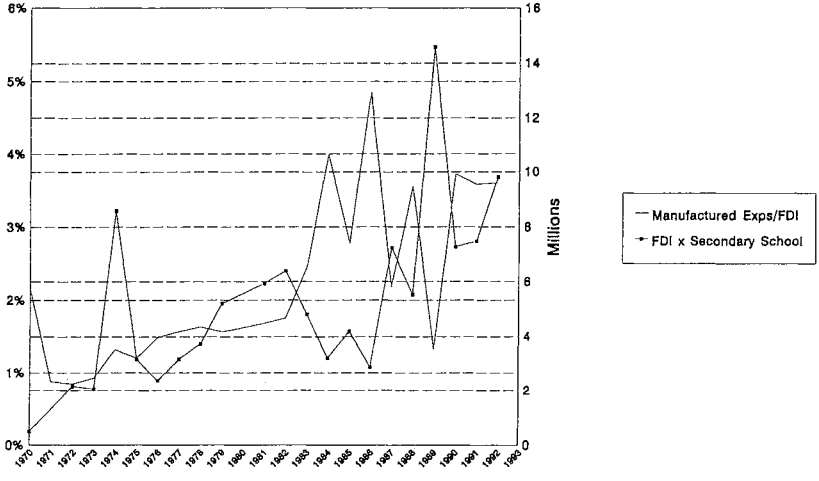


Figure 3 Manufactured Exports to Foreign Direct Investment and Foreign Direct Investment x Secondary Schooling



predominantly agricultural and a trade structure dominated by exports of fuels and other primary products (92 per cent) and imports of machinery and other manufactures (69 per cent), the conditions for successful regional integration appear to be lacking.

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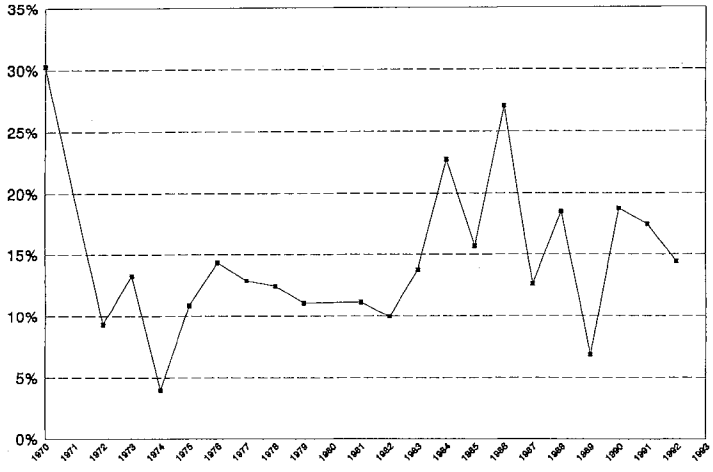
Figure 4 Manufactured Exports as a ratio of Foreign Direct Investment x Secondary Schooling



It has been argued (Gunning, 1995) that there is a more fundamental criticism than the one pointing to incomplete implementation, and that students of regional integration in Africa agree that it is an idle hope that trade policy could be used to promote regional integration by reciprocal discrimination between members of a regional scheme. The argument is simply that most African countries are too similar in endowments (unlike, for example, the members of the North American Free Trade Agreement, NAFTA) for such collusive trade policy to lead to substantial trade creation. In this view regional integration is – with the exception of schemes involving South Africa – at best vacuous (de Melo et al., 1993) and at worst trade diverting.

Gunning (1995) argues further that while in Africa regional integration has probably been pursued for the wrong reason, it can nevertheless perform a useful function. He notes that unilateral trade reform has often failed since it is usually undertaken in circumstances where trade liberalisation is time-inconsistent. In structural adjustment programmes there have usually been no incentives for maintaining reform and no credible penalties for policy reversals. The absence of a mechanism for locking-in reform, reversals of trade liberalisations and other economic reforms have become a serious problem in Africa.

In the past five years there has been renewed interest, and significant changes, in the approach to regional cooperation. The fear of the region's increased marginalisation has intensified in response to the perception of

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growing regionalisation of the world economy. Unilateral tariff liberalisation in many countries implementing economic reforms has questioned the previous emphasis on preferential tariff treatment for members. The more liberalised economic and political environment in many countries in the region has opened up opportunities for parties other than governments to pursue economic cooperation initiatives.

All these integration groupings attempt to build on the common characteristics and goals of relatively smaller groupings. However, their activities need to be conducted in such a manner that they harmonise with, and converge towards, those of larger sub-regional groupings such as the Economic Community of West African States (ECOWAS) and the Common Market for Eastern and Southern Africa (COMESA). Small groups progressing at different speeds are useful mechanisms in the interim, but this should not preclude the goal of strengthening larger integration arrangements which would be more commensurate with global developments in this respect. Such an approach, while facilitating achievement of the Abuja Treaty, could also pave the way for future relations with other regional trading blocs (Global Coalition for Africa, 1995).

Under regional integration arrangements (RIAs), there must, at the very least, be a willingness on the part of partners to agree on a minimum harmonisation of incentives if the benefits of integration are not to be dissipated in higher costs due to smaller scale production than a regional market warrants. This need not mean complete uniformity of incentives, especially if there are large disparities in the levels of development of members in an RIA. To make sure that the benefits of integration are appropriately distributed, it might be appropriate to allow certain countries to offer more favourable incentives, as is permissible in the case of the European Union's (EU) own regional policy. Differentiation on such grounds would imply a trade-off between efficiency and equity, but this may have to be accepted as the price of regional accord and to achieve the objective of levelling-out.

The new initiatives have also broadened the range of objectives for regional cooperation to include the removal of non-tariff barriers to trade; facilitating capital mobility and other business transactions; addressing sectoral issues; and pursuing conflict resolution. Constraints of multilateral agreements make "open regionalism" necessary, rather than closing the region to the rest of the world. The region seems to be moving in the direction of "variable geometry", providing for flexible institutional frameworks and accommodating progress at different speeds consistent with the Abuja Treaty (1991) principles. Furthermore, adoption of the principle of "subsidiarity", which involves the broadening of the participation of the private sector and other stakeholders in cooperation decisions,

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promises to keep the responsibility of dealing with issues of interest as close as possible to the concerned population.

These developments represent a significant departure from the past, building on existing institutions but accommodating greater flexibility in membership and rationalisation of operations.

The key question that has been posed by Elbadawi and Ndulu (1995) in the light of the glaring failures in regional integration schemes in SSA and the rekindled interest in regional integration arrangement in recent years is: can the current regional institutions in SSA guarantee market integration?

In a comprehensive paper, Fine and Yeo (1994) argue against renewed regional integration efforts in SSA along the traditional lines, where the existing regional schemes are called upon to attempt directly promoting regional trade despite repeated failures. In their view, these schemes are inappropriately structured, since they were designed to pursue the now ill-fated and out-moded import-substitution development strategy. They propose a new paradigm for regional integration in SSA inspired by the experiences of post-War II Europe and the recent "miracle" experience of East Asia. Regional integration initiatives in SSA should be designed to achieve the twin objectives of fostering national policy credibility, and rapid physical and human capital accumulation, the latter being initially triggered by enhanced direct foreign investment and by saving and investment surges within the region in subsequent stages. Fine and Yeo provide an exhaustive review of the evidence linking regional integration to these two objectives, which are now being accepted as the two main fundamentals behind East Asia's economic miracle.

Elbadawi and Ndulu (1995) argue that the key element of this strategy adopts the Collier (1991) and Collier and Gunning (1993) proposal of "participatory supranational agencies of restraint" in which national economic policy will be tied in a reciprocal threat-making arrangement to a northern anchor (e.g. the European Union). Fine and Yeo then ask the question as to why the European Union might be interested in playing such a role and argue that unlike the case of Eastern Europe, enhancement of trade, fear of mass migration or imminent security concerns could not be major factors. Instead, they suggest that the precedent of *Union Economique et Monétaire Ouest Africaine* (UEMOA); the vast interest of the EU in South Africa; the realisation that the African, Caribbean and Pacific (ACP) agreement which is administered by the European Commission has met with limited success; and the growing EU concerns with political stability as a prerequisite for economic growth may prompt a more active policy towards SSA. More recently, Gunning (1995) provides a further articulation of this argument, including an important extension linking the

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above approach to regional integration with direct foreign investment. This will be discussed further in Section Three below.

Four important current initiatives are pointing the way to a more pragmatic regional integration policy.

- The integration initiative to facilitate cross-border investment, trade, and payments in Eastern and Southern Africa and the Indian Ocean – the Cross-Border Initiative (CBI) – is pushing for accelerated tariff reductions between participating countries. It is establishing external payments and domestic regulatory systems to permit scarce investment capital to pursue the most efficient location, thus creating more growth throughout the region.
- The transformation of the *Union Monétaire Ouest Africaine* (UMOA) into a monetary and economic zone (UEMOA) includes provisions for coordination and harmonisation of macroeconomic and sector policies; creation of a single market for goods, services and factors of production; and harmonisation of the administrative and legal framework regulating economic activity.
- Recent reform of the *Union Douanière des Etats de l'Afrique Centrale* (UDEAC) is also designed to reform the tariff and indirect taxation systems, facilitate transit traffic, and strengthen monetary policy and financial management.
- Similarly, in Southern Africa, SADC is exploring the scope for harmonisation of macroeconomic policies among its members.

Clearly, all integration initiatives will have to be designed and pursued in an outward-oriented manner, consistent with achieving multilateral liberalisation. At the heart of these arrangements must be the objective of making trade and investment easier across present borders, allowing not only gains from trade but those from scale economies to be reaped.

This paper is divided into five sections. Section One covers the introduction, Section Two reviews the literature related to regional cooperation and using the gravity model tries to establish the potential for trade flows within the current regional economic groupings in SSA. In Section Three we discuss the link between foreign direct investment and regional integration arrangements with reference to SSA. Section Four deals with the empirical evidence of intra-regional foreign investment flows. This section discusses trade flows particularly in manufactures and the factors that influence the increase in intra-regional trade flows in manufactures which may foster enhanced regional economic cooperation. It then examines to what extent foreign direct investment (FDI) may lead to an increase in manufactured exports where in this case increases in manufactured exports have been used as a proxy for increased intra-regional trade flow in the econometric estimation. The section draws partly from the literature

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which emphasises that success with regional integration arrangement has occurred where trade in differentiated products, intra-industrial and intra-firm trade across member countries is dominant. Section Five ends the paper with some concluding remarks.

II Sub-Saharan Africa's Trade Potential

Earlier studies that have investigated the potential for intra-SSA trade include Ogunkola (1994), Foroutan and Pritchett (1993), Elbadawi (1995a) and Lyakurwa (1995) among others. The results of the econometric estimates using gravity models indicate that although intra-regional trade flows are low there is significant potential for increased flows.

In this section, using an expanded data set, we try to estimate the SSA trade potential using the gravity model and applying dummies to take into account the various regional groupings in SSA with a view to determining whether there is significant trade potential within the region. This section is also used to stimulate discussion on investment integration in SSA. The growing importance of foreign direct investment (FDI) as a means of accessing capital, technology, skills and foreign markets is accompanied by a (market) expansion of intra-firm and inter-firm trade by multinational corporations (UNCTAD, 1995b). Investment, trade and technology flows are closely intertwined and the potential benefits of FDI are widely recognised by developing countries as a contribution towards the achievement of their development objectives.

Regression Equation

$$TRADE_{ijt} = \alpha + \beta_1\ 1n(GDP_{it} \times GDP_{jt}) + \beta_2\ 1n(GDPPCit \times GDPPC_{jt}) + \beta_3\ DIST_{ij} + \beta_4\ ADJ + \beta_5\ COMESA + \beta_6\ UDEAC + \beta_7\ SADC + \beta_8\ CEPGL + \beta_9\ CEAO + \beta_{10}\ ECOWAS + e$$

Method of Estimation = Ordinary Least Squares
Number of observations: 3675

Variables

$TRADE_{ijt}$: Natural log of intra-country imports for each year between 1980-1992.

$(GDP_{it} \times GDP_{jt})$: Natural log of the product of the real GDPs of country i and j at time t.

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($GDPP_{it}$ x $GDDP_{jt}$): Natural log of the product of the per capita GDPs of country i and j at time t.

$DIST_{ij}$: The straight line distance in miles between country i and j.

ADJ: A dummy variable: 1 if the two countries share a border and 0 otherwise;
Regional Dummies: 1 if both countries belong to the regional grouping and 0 otherwise; COMESA, UDEAC, SADC, CEPGL, CEAO and ECOWAS.

Country Sample

All countries in sub-Saharan Africa that are members of the IMF were used. Angola, Seychelles, Djibouti, Reunion and Mauritius were dropped due to the unavailability of GDP data. Intra-SACU trade data was also unavailable and hence SACU as a regional grouping was dropped from the analysis.

Organisation of Data

A pooled format was used with each available import value between reporter and partner along with all the other variables represented an observation.

All available import data for pairs of countries (reporter and partner) in SSA between 1980 and 1992 were collected and tabulated. As a result, 12,207 observations were realised. Due to the unavailability of GDP data, 8,257 observations were dropped leaving 3,675 complete observations. Each observation consisted of the following variables: Reporter, Partner, Year, GDP, GDPPC, Distance, Adjacent, <Regional Dummies>.

For example, for i = Mozambique, j = Benin and t = 1980
$TRADE_{ijt}$, GDP_{ijt}, $GDPPC_{ijt}$, DISTij, ADJ, [+ all regional dummies] would be one observation.

GDP is a measure of total economic size and in the gravity model it stands for the natural log of the product of the pair of countries' GDPs. That is, (GDP_i x GDP_j) where GDP_i is the real GDP of the reporter country and GDP_j the real GDP of its trading partner.

GDPPC – countries with similar living standards could realise higher level of intra-industry trade to the extent that they share a broader range of goods to trade. On the other hand, to the extent that GDPPC differences

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are highly correlated with differences in factor endowments, inter-industry trade driven by comparative advantage could be smaller between countries with similar level of income.

The variable distance was measured as the straight line distance (in miles) between capital cities regardless of whether the countries are islands or non-contiguous. The exception was South Africa where Johannesburg was used instead of Pretoria.

Methods of estimation = Ordinary Least Squares
Dependent variable: TRADE
Number of observations: 3675

The results of the regression estimates are shown below and the standard errors are heteroskedastic consistent (HGTYPE=2).

Regression Results

Variable	Estimated coefficient	Standard Error	t-statistic
C	-29.9043	2.55.21	-11.7262
GDP	.750078	.035322	21.2353
GDPPC	7.13236	1.19593	5.96386
DIST	-.345825E-03	.663401E-04	-5.21290
ADJ	.654900	.132875	4.92870
COMESA	.858100	.154931	5.53858
UDEAC	-.084336	.286960	-.293895
SADC	1.33212	.206915	6.43802
CEPGL	.031308	.385402	.081235
CEAO	-.096303	.188886	-.509844
ECOWAS	.962625	.172083	5.59397

Mean of dependent variable	= 13.2257	Adjusted R-squared	= .171518
Std. dev. of dependent var	= 3.24.59	Durbin-Watson statistic	= .987956
Sum of squared residuals	= 31877.6	F-statistic (zero slopes)	= 77.0615
Variance of residuals	= 8.70022	Schwarz Bayes. Info. Crit.	= 2.18492
Std. error of regression	= 2.94961	Log of likelihood function	= -9184.24
R-squared	= .173773		

The results of the econometric estimation indicate that the variables GDP, GDP per capita, distance and adjacency are significant determinants of the trade potential in SSA. Applying dummies for regional groupings, it can be observed that there is significant trade potential within COMESA, SADC and ECOWAS which is consistent with the results of earlier studies. The other regional groupings do not demonstrate significant trade potential as indicated by the results of the econometric estimation.

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It should be noted that ECOWAS, COMESA and SADC are the largest regional groupings and with the monetary arrangement within CFA, which is also part of ECOWAS, intra-regional trade flows may easily be facilitated. It should also be noted that both ECOWAS and COMESA have established clearing house mechanisms where intra-regional payments can be settled without recourse to foreign currency. However, the utilisation of the clearing house mechanism has been very limited. This may be explained in part by the fact that a majority of the countries in SSA have implemented structural adjustment programmes which involve substantial trade and foreign exchange liberalisations wherein availability of foreign exchange has become less of a constraint in trade finance. However, recent reversals of the reform process in Nigeria may affect official intra-regional trade flows in the region though unofficial trade flows which have thrived over the years should not be affected.

In the case of SADC, there was also a mechanism put in place to extend foreign exchange to firms producing for the regional market (Export Prefinancing Revolving Fund established under the acronym NORSAD Fund). The objective was to assist and support the creation of commercially viable enterprises that would contribute positively to the economy of the host country. This objective would be achieved by supporting export oriented projects which optimise the use of local raw materials. By 1994 a total of DKr 200 billion had been earmarked for this activity but by the end of the year only DKr 30 million had been disbursed. It has been argued that supporting credit facilities might encourage intra-regional trade but in most developing countries, and in particular in SADC, the absence of donor interest in providing financial support to public institutions, which in most cases are not financially sound, has made it difficult for implementing such facilities to the extent required. The Export Prefinancing Revolving Fund, as in the case of the clearing house mechanism, is no longer as attractive as it was during the period of the foreign exchange crisis. The constraining factor is now the availability of local currency to acquire foreign exchange. All said, despite the presence of significant trade potential within some SSA regional groupings, trade flows have been very low as has been observed earlier.

One of the oldest schemes, the sixteen member Economic Community of Western African States (ECOWAS) may serve as an example of the failures of regional integration groupings in SSA. ECOWAS became effective in 1977. According to the 1975 Treaty, trade liberalisation was to start in 1979 and to be completed by 1989. In fact, trade liberalisation did not even start until 1990, fifteen years after the signing of the Treaty (Jebuni et al., 1995) and so far none of the goals set out in the Treaty have been reached. ECOWAS is dominated by one very large country, Nigeria, and

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fear of Nigerian hegemony has made the other members reluctant to import Nigerian goods (at least officially; there is a thriving parallel market). Conversely, Nigeria is suspicious of the Franc Zone membership of its fellow ECOWAS members. To make matters worse, Nigeria reversed seven years of liberalisation in 1993, including the trade reforms it had initiated in 1986.

In the case of one of the relatively successful schemes, the Customs Union of Central African States (UDEAC), a common external tariff was one of the objectives. In fact, as documented by Decaluwe et al. (1995), the members adopted widely different rates. In one case all six member countries used different rates, ranging from 8 to 49.5 per cent (Gunning, 1995). Similarly, the CEAO is supposed to have a common external tariff but this is not effective and the members frequently use non-tariff barriers against each other. The Common Market for Eastern and Southern Africa (COMESA), which aims at complete trade liberalisation by the year 2000, indicates that while all members should have attained tariff reductions of up to 60 per cent by 1993 only six of the 20 members had their tariffs published by then.

The lack of success of the regional integration attempts is also illustrated by the experience of structural adjustment in Africa. Typically, far-reaching changes in economic policies, including trade policy, have been achieved under structural adjustment programmes, but without coordination or even consultation with fellow members of regional groupings. Foroutan (1993, p. 239) concludes that "thus far [there has not been] any meaningful trade integration in SSA". Indeed, the share of intra-group exports in total exports is minimal in almost all schemes and often has stagnated or even fallen after the start of regional integration. Would the schemes have been more successful if regional integration had been more seriously pursued? A growing literature[2] gives a negative answer.

The above analysis and the conclusions reached, notwithstanding, there is a window of opportunity for SSA to use regional integration as a supra-national mechanism to foster national policy credibility, and as a means for pooling risks between otherwise vulnerable small economies; to resolve conflicts and minimise political risks; to exploit complementarities; and to develop regionally-based links in a *reciprocal and mutually* beneficial basis. Reciprocity is a key word here because it is the only guarantee against having strategic cooperation with a dominant economic and political core stifling considerably indigenous African initiative for owning and under-

2 See, for example, Foroutan (1993), Foroutan and Pritchett (1993), Gunning (1994), Collier and Gunning (1995), Fine and Yeo (1994), Elbadawi (1995), Lyakurwa (1995).

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taking their own development vision. In this context the new regional schemes in SSA should also take into account, the incentives facing the government bureaucracy and the private sector; address the issues of concentration and agglomeration, and the distribution of gains and losses; attempt to deal creatively with the problems of "hub and spoke"; and create strong institutions that can effectively implement integration measures. (Elbadawi, 1995a).

III The Link Between Foreign Direct Investment and Regional Integration Arrangement.

Theories of intra-industry trade which are based on the neoclassical trade theory offer explanations of comparative advantage as a result of factor endowment, draw attention to technological differences between countries and accord an important role to economies of scale.

The development of intra-industry trade, while based on differences in endowments, also depends on market imperfections such as economies of scale in production, technological leads and lags, learning from experience, product differentiation and linkages between industries. In this way it can be explained why particular products within industry groups are competitively manufactured in particular locations (Keesing and Lall, 1992). National economic characteristics do not fully determine trade patterns, intra-industry trade flows rely to a large extent on regional economic cooperation.

However, both the old and new trade theories do not properly recognise other critical problems of exporting manufactured goods from developing countries, such as obtaining access to competitively priced inputs, export incentives, services and infrastructure. The complexity of learning to export, the information required and the vulnerability of exports to inappropriate government controls and policies require coordination at national and at the regional level. For further discussion of export promotion measures see Lyakurwa Lyakurwa (1990).

The importance of FDI participation in manufactured exports and of intra-firm trade more generally have been observed by many authors (Helleiner, 1973; Naygar, 1978). Both seem to be on the increase under the influence of the trading opportunities made possible by both regional and global vertical integration. Most SSA economies need to develop a significant amount of manufacturing for export to foster increased intra-regional trade flows. The issues that have been raised but not discussed in this paper in any detail are: What type of technology, marketing and other promotional policies are necessary to support manufactured exports for regional as well as global markets?

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It has been observed by Musonda (1995) that intra-industry trade is more common among countries at the same level of development, that have similar tastes and similar levels of factor endowments, among others. She argues that this trade is further enhanced by the formation of regional groupings since the removal or reduction of trade barriers increases trade in general and intra-industry trade in particular. This explains why similar types of products are traded among neighbouring countries.

Most African countries have now adopted national regulatory frameworks conducive to FDI. They permit profit repatriation and provide tax and other incentives to attract investment. In addition, efforts to increase FDI inflows have included the simplification of the investment-approval process (e.g., by setting up "one-stop" investment centres), the establishment of investment-promotion institutions and the increased use of representative offices abroad to publicise investment opportunities. In addition, the parastatal reform process, which involves the sale of a large number of parastatals, should provide an additional window for FDI inflows. The reformist mood has been widespread and, at times, exhibited itself in quite rapid policy and legislative changes. For instance, in just one five-year period alone (between 1982 and 1987), about one half of all African countries either introduced or made adjustments to their investment codes or guidelines in order to attract more FDI. The end of the 1980s and the beginning of the 1990s also saw many other countries among the other half introduce new investment laws or amend old ones. Countries that have traditionally been regarded as being relatively open to FDI, such as Kenya and Zimbabwe, went out of their way to revise their regulatory frameworks to become more attractive. But even countries with a previous reputation of hostility to FDI, such as Ethiopia, Guinea and Mozambique, introduced new legislation offering a wide range of guarantees and opportunities for foreign investors. Prospectively, all these new measures should lead to inflows of FDI.

It would be natural, therefore, to infer that the specific trade orientation embodied in the different waves of incoming foreign investment would influence very significantly the outward orientation of the industrialisation drive. However, little has been done in this direction. The present study is an attempt to establish possible linkage between manufactured exports and FDI. It has been observed that the high export growth rates in Brazil were not confined to natural resource based or labour intensive industries. Export performance was also exceptionally good in sectors receiving "vintages" or more outward oriented FDI, and in several of the more technology or capital intensive sectors intensive FDI penetration during the formative stages was a critical factor (Fritsch and Franco, 1992).

Notwithstanding the liberalisation of FDI regimes – at least in terms of

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removing foreign ownership limitations – most countries still maintain a requirement that the government must approve the establishment of any FDI project. In other words, they have in place a "screen-and-approval" process for foreign investors. Proposed investments have to meet certain criteria stated in the investment code in order to obtain approval. However, several countries are recently adopting more open regimes. In some cases such as Namibia, there is no approval process, and national treatment is assured by law. In others, such as Mozambique and Eritrea, there is no specific requirement for FDI approval, but many foreign investors nevertheless go through an approval process to obtain wide-ranging tax concessions.

Much of the focus of the discussion on regional integration in SSA rightly focuses on trade aspects. It should be noted that also crucial in the integration process – especially regionally but also multilaterally – are its international financial aspects. Although very important, these financial aspects tend to be insufficiently emphasised in many of the studies on integration as well as in policy discussions on the subject.

It has been argued (Griffith-Jones, Canto and Ruiz, 1995) that there are at least five major aspects in which international financial flows and mechanisms play a very important role in regional integration:

1. Financial mechanisms are created explicitly with the purpose of enabling or facilitating trade integration. As mentioned earlier, the COMESA and ECOWAS clearing house mechanisms were established to facilitate payments and clearing arrangements for intra-regional trade. The relevant question that needs to be addressed is whether the mechanisms created operate efficiently and whether they are sufficient and on appropriate terms to meet the needs of integration. As noted earlier, the performance of the clearing house mechanisms in facilitating intra-regional trade flows has been fairly limited. Similarly, the NORSAD fund established to support SADC institutions to increase production for the sub-region, did not perform as effectively as it had been anticipated. Part of the reason was that the NORSAD management did not have sufficient staff to deal with requests from all the countries in the region.
2. Regional integration can be more or less spontaneously stimulated by intra-regional direct investments. Such flows have played a particularly large role in the market-driven integration processes of Asia; they are also, however, playing a fairly important role in the move toward the policy-driven process of Western Hemisphere integration. Insufficient research and data compilation hinders full understanding of this phenomenon (Griffith-Jones et al., *op. cit.).*
3. Regional integration leads to a process of increased investment from

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outside the region. This dynamic effect of investment creation for the country or region relates to the additional flows of foreign investment from outside the region generated by three factors linked to regional integration: (a) preferential and stable access to a significantly larger market; (b) potential regional complementarities in terms of resources and productive capacity; and (c) a decline in uncertainty on economic policies which countries will follow, called the "lock-in" effect.

4. To the extent that FDI represents an addition to a country's capital stock, it affects resource allocation in a number of ways. It affects capital accumulation, industrial structure and the country's trade propensity with a bias towards outward orientation.
5. It is important to observe that foreign subsidiaries are perhaps more sensitive to changes in the policy environment within which they operate. Since export promotion has become one of the more common performance requirements, this, to some extent, explains why some multinational corporations have become over-reactive to incentives for export promotion for both intra-regional and extra-regional markets.

IV Intra-Regional Foreign Investment Flows: Empirical Evidence

It has been argued (Griffith-Jones et al., *op. cit.)* that an important distinction made in the literature on economic regionalism is that between market-driven (or *de facto)* versus policy-driven (or *de jure)* regionalism. The classical example of policy-driven regionalism is European integration, whilst the main example of market-driven regional integration is the Asian experience. Within this latter process, intra-regional foreign direct investment has played a key role in supporting both rapid economic growth in that region and stimulating rapidly growing intra-regional trade. Indeed, while in the 1980s, 70 per cent of investment flows from underdeveloped countries were channelled to the developed world, the majority of Asian FDI flows went to developing countries in Asia, mainly for investment in export-oriented manufacturing.

Africa seems to lie at the bottom of the ladder. Though to an important extent integration within Africa is policy driven, there is emerging an increasingly dynamic undercurrent of market-driven investment flows stimulated by the substantial trade and payments liberalisation that has taken place. As the growth of intra-regional investments is a new phenomenon, information on these investments is completely lacking and efforts at analysing their impact are even more rudimentary. In what follows, we will attempt to present a broad picture of FDI in SSA and by proxy try to estimate the effects of FDI on the export of manufactures. If attention is focused on manufactures, growth and shares are notably higher though

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Table 1 FDI Inflows to Africa, 1981 - 1994

(billions of dollars and percentages)

Region/Country	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994a/	Total 1981-94	Annual Averages 1981-85	1986-90	1991-94
All Countries	63.7	54.6	50.4	58.9	58.5	84.0	136.0	161.4	198.6	210.4	162.3	163.4	184.5	204.0	1,790.6	57.2	158.1	178.5
Developing Countries	20.6	25.7	17.1	18.2	15.4	16.2	22.6	29.0	28.6	33.9	40.3	53.2	71.8	83.6	476.2	19.4	26.1	62.2
Africa	1.4	1.4	1.2	1.4	2.9	1.8	2.5	2.8	4.8	2.2	2.8	3.3	2.9	3.5	35.0	1.7	2.8	3.1
Africa's share in %																		
All Countries	2.2	2.6	2.4	2.4	4.9	2.2	1.9	1.7	2.4	1.0	1.7	2.0	1.6	1.7	2.0	2.9	1.8	1.8
Developing Countries	6.8	5.6	7.0	7.9	18.9	11.3	11.2	9.6	16.8	6.5	7.0	6.1	4.1	4.2	7.4	8.6	10.8	5.0
Oil Exporting Countries of Africa, b/ c/ (billions of dollars)	1.1	1.0	1.2	1.1	2.5	1.7	1.8	2.1	1.2d	2.1	1.8	2.3	1.8	2.3	24.3	1.4	2.0	2.1
- Egypt	0.8	0.3	0.5	0.7	1.2	1.2	0.9	1.2	0.7	1.2	0.5	0.5	0.5	0.5	9.8	0.7	1.1	0.4
- Nigeria	0.5	0.4	0.3	0.2	0.5	0.5	0.6	0.4	0.6	0.4	0.7	0.8	0.9	0.8	8.2	0.4	0.7	0.8
Other, non-oil exporting countries of Africa c/	0.3	0.4	0.02	0.3	0.4	0.2	0.7	0.7e/	1.4e/	1.0e/	1.0	1.0	1.1	1.2	9.3	0.3	0.8	1.1
Share in Africa's total f/(percent)																		
Oil Exporting countries	80.5	70.7	98.0	80.5	87.6	90.3	71.7	74.8	71.4	56.5d	65.0	69.6	62.5	66.1	69.5	83.7	72.2	65.9
- Egypt	53.6	20.5	40.8	50.9	41.2	66.6	37.7	42.8	26.0	33.3	9.0	14.1	16.8	15.1	27.9	41.3	37.8	13.9
- Nigeria	38.9	30.1	28.6	14.0	16.7	9.1	23.9	13.6	39.1	26.6	25.3	27.5	24.9	22.2	23.4	24.0	25.6	24.9
Other Countries	19.5	29.3	2.0	19.5	12.4	9.7	28.3	25.2	28.6	43.5	25.0	30.4	37.1	33.9	26.5	16.3	27.8	34.1

Sources: UNCTAD Division on Transnational Corporations and Investment, based on IMF, balance-of-payments tape, 15 March 1995; estimates of the OECD and official national sources.

a/ Estimates.

b/ Algeria, Angola, Cameroon, Congo, Egypt, Gabon, Libyan Arab Jamahiriya, Nigeria and Tunisia.

c/ Figures may not add up to Africa's total because of rounding.

d/ Africa's total is less than the total for Egypt and Nigeria because it includes disinvestment in other countries

e/ Figures are inflated by unusually high investment in Liberia in 1988-1990 ($290, $656, $225 million, respectively), most likely in flags-of-converience facilities. Inflows to "other Africa" net of Liberia were as follows: 1987 - $674 million; 1988 - $411 million; 1989 - $719 million; 1990 - $735 million and 1991 - $977.1 million.

f/ Percentages based on the figures before rounding.

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FDI to GDP ratios have been declining (see Figure 2). It has been argued that intra-regional exports are actually more intensive in manufacture and in non-traditional products (Ffrench-Davis, 1995; Lyakurwa, 1995).

FDI flows to Africa increased marginally from $1.4 billion in 1981 to $2.8 billion in 1988 and $4.8 billion in 1989 but declined drastically to $2.2 billion in 1990 and have since been rising slowly to $3.5 billion in 1994. As a ratio of GDP, however, the trend has been declining between 1970 and 1993 (see Figure 2). When this trend is compared to all developing countries, a different picture is observed. While FDI flows to all developing countries increased from $20.6 billion in 1981 to $33.9 billion in 1990, there was a very significant jump from $33.9 billion in 1990 to $83.6 billion in 1994 with Africa's share only at 4.2 per cent (see Table 1).

Net foreign direct investment in Africa increased sharply from $0.4 billion in 1988 to $1.1 billion in 1990. It has averaged about $1.8 billion between 1991 and 1995. In contrast, net foreign direct investment in Asia increased rapidly from $9.8 billion in 1990 to $41.4 billion in 1994, an increase of over 400 per cent and representing about 70 per cent of the net flow to developing countries. This high growth declined slightly to $36.8 billion in 1995 representing about 65 per cent of the net flow to developing countries (see Table 2).

Table 2 Developing Countries: Net Foreign Direct Investment, 1988-96*

	1988	1989	1990	1991	1992	1993	1994	1995	1996
Developing countries	19.0	17.6	19.0	27.2	34.5	49.2	59.2	56.2	54.9
Africa	0.4	3.7	1.1	1.4	2.5	0.7	2.5	2.1	3.1
Asia	8.6	5.6	9.8	13.7	17.6	33.9	41.4	36.8	33.4
Middle East and Europe	1.3	1.2	1.2	1.0	1.7	1.3	0.6	0.8	1.3
Western Hemisphere	8.7	7.2	6.9	11.2	12.8	13.4	14.8	16.5	17.0

* Projected data for 1996.
Source: International Monetary Fund, *World Economic Outlook*, Data Base.

It may be noted that as a result of severe foreign exchange shortages, many African countries imposed restrictions on capital flows in the 1970s and 1980s, including capital repatriation. Over the years, many of the countries recognised that their foreign exchange control laws were a strong disincentive to foreign investors and decided to guarantee foreign investors a right to repatriate capital and profits, thus exempting them, to a certain extent, from the otherwise restrictive foreign exchange regime.

Although there may not be a one-to-one correspondence between low FDI flows and real output growth, there is evidence that FDI, when complemented with adequate human capacity, engenders growth via technological learning and crowding in of domestic private investment (Elbadawi and Ndulu, 1995; see also Figure 3). Africa's real output growth has been below 2 per cent per annum between 1986 and 1994 while real output growth for all developing countries has increased from 4.8% in 1986-90 to 6.1% in 1993 and 5.6% in 1994 with Asia registering the highest growth rates of over 8% per annum (see Table 3). While FDI flows to Africa were low during the 1980s and the early 1990s, the continent's foreign indebtedness reached high levels in the 1990s with total debt rising from $249.55

Table 3 World Real Output Growth, 1986 - 1994
(annual percentage change)

Region and Sub-Region	1986-1990	1991	1992	1993	1994
World	**3.6**	**0.9**	**1.7**	**2.3**	**3.1**
Industrialised countries	**3.2**	**0.8**	**1.5**	**1.3**	**2.7**
United States	2.7	-0.6	2.3	3.1	3.7
European Union	3.3	1.2	1.1	-0.3	2.1
Japan	4.5	4.3	1.1	0.1	0.9
Other industrialised countries	2.8	-1.1	0.6	1.5	3.5
Developing countries	**4.8**	**4.5**	**5.9**	**6.1**	**5.6**
Africa*	-	2.7	1.2	0.7	1.9
Asia	7.1	6.2	8.2	8.5	8.0
Middle East and Europe	3.3	1.9	7.0	4.8	1.4
Latin America and the Caribbean	2.1	3.4	2.5	3.4	2.8
Countries in transition					
Central and Eastern Europe	-	-11.5	-11.7	-5.7	-5.4
Russia	-	-13.0	-19.0	-12.0	-12.0
Transcaucus and Central Asia	-	-8.2	-17.3	-10.7	-6.6

* African Development Bank estimates for regional members only.
Sources: IMF, *World Economic Outlook*, October 1994.

billion in 1990 to $269.47 billion in 1994 and the debt service ratio increasing from 30.54% to 35.38% over the same period (UNCTAD, 1995a). At the same time, the continent experienced capital outflows of around $2 billion per annum between 1990 and 1994 (UNCTAD, *op. cit.).* These figures present a disappointing picture in terms of SSA future growth prospects.

Capital investment and technological progress are the keys to economic growth. While the production of technology (that is, research and development) is largely concentrated in the developed world, its results spread rapidly through licensing and direct foreign investment. The effective absorption of this advanced technology and hence its growth effect, critically depends on the presence of a level of human capital in the host country (Borensztein et al., 1994; Elbadawi and Ndulu, 1995). Secondary education attainment is considered the prime measure for attaining the required human capacity and competence for the effectiveness of FDI in generating growth. There is a large volume of literature on direct foreign investment and the multinational corporations, but in general the quantitative documentation available is poor (Blackhurt, et al., 1978). In SSA, as a result of the declines in GDP growth rate which gives rise to lower budgetary allocations to education expenditures and the very high population growth rate, the trend in secondary school enrollment has been on the decline (Figure 1) and this is likely to pose a very serious constraint to future economic growth in the region.

It has been argued that regional cooperation in SSA requires an external anchor to be viable and sustainable (Collier, 1991; Collier and Gunning, 1995; Elbadawi, 1995a; Fine and Yeo, 1994). This might be an attractive option if it would lead to increased FDI into the region. It has further been argued that such a proposal would be reciprocal; access for the exports of the regional grouping to the northern anchor would be conditional on the regional group removing restrictions on imports from the north.

The link between integration with a major market and increased FDI seems to be confirmed by the experience of Portugal and Spain when they joined the European Community (EC). FDI to those countries increased significantly, apparently showing the close link between increased FDI and regional integration with a very important market. However, it should be stressed that participation in a regional market though necessary is not a sufficient condition for a developing country to attract FDI. Greece joined the EC, but did not experience a large increase in FDI inflows. (Griffith-Jones et al., *op. cit.)*

A key question posed by Gunning (1995) is how the sub-regional groups should be organised. He proposes the formation of small groups of nations submitting themselves to a participating supranational agency, following

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the model of the franc zone. Such an arrangement may attract foreign investment for two reasons. First, it creates credibility which attracts investment by reducing option values. Collier and Gunning (1995), Fine and Yeo (1994) and Gunning (1995) argue that if there is no uncertainty about whether (and in what direction) policy will change then investors will have no incentive to remain liquid or engage in what has come to be known as "foot loose investments". This is important since there is growing evidence that policy uncertainty is currently the main impediment to foreign investment in Africa. However, Elbadawi (1995b) argues that even in the aftermath of stabilisation (in Latin America and now SSA) it has been observed that capital (new or flight capital) does not return and even if it does, it is usually placed in liquid form rather than irreversible assets. Anecdotal evidence suggests that the recent repatriation of capital flight and the flow of new private capital in SSA following trade and exchange liberalisations may be motivated by speculative behaviour. When the domestic rate of return is not sufficient to warrant the risk of repatriation, no capital comes in.

Another point that has been raised regarding FDI is relevant here. It has been argued that additional FDI and other capital flows, linked to regional integration, have important economic benefits, both of a macroeconomic kind (by providing foreign exchange that allows higher growth) and a microeconomic kind (by facilitating improvement of technology and management). However, there are also risks in capital flows, especially clear in non-FDI flows. Thus, surges in capital flows can – and recently have – led to overvaluation of currencies, which discourages exports, even though increased exports are precisely a key aim of regional integration. Clear examples of over-valuation arising from increased capital flows have recently been observed in Kenya and Uganda, and to a lesser extent, in Tanzania. Increased capital inflows may also partly replace domestic savings, and therefore lead only partly to increased investment. If insufficient capital inflows are channelled into increased investment in tradable, the country could be creating balance of payments problems for the future. If inflows are to a large proportion devoted to increased investment in tradeable (more likely in the case of FDI), their long-term effects are more likely to be beneficial. Recent events in Mexico have demonstrated that portfolio and short-term capital flows can be incredibly volatile, with very negative effects on countries' economies.

Finally, we should point to the importance of the "neighbourhood effect". Widespread return to democratisation of South Africa is likely to lead to a surge in FDI with South Africa possibly acting as a conduit for the rest of the sub-region. Much is expected of South Africa and the "regional pole" projected to emerge in the south with growth there.

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Already, investment by South Africans in other countries in Africa are beginning to occur at an increasing rate. For example, South African Breweries has 50 per cent shareholding in Tanzanian Breweries; Alliance Airlines in a joint venture between South African Airways, Uganda Airlines and Air Tanzania; and Aero Zambia, a small private carrier that replaced the collapsed Zambian Airway, has its base in South Africa. In the rail sector, the South African Company Spoornet is already heavily involved with railways elsewhere in Africa. A number of South African financial institutions have subsidiaries in the Eastern and Southern African sub-region. The hotel and tourism industry is also attracting substantial South African investments in the sub-region. More recently, Kenyan registered banks have opened subsidiaries in both Uganda and Tanzania to take advantage of the improved investment climate in both countries.

The increase in cross-border investments is more likely to lead to enhanced intra-regional trade flows. However, South Africa could play a more significant role in both intra-regional trade flows as well as increased cross-border investment in Eastern and Southern Africa if present controls were removed. The contemplated liberalisation of trade and foreign exchange controls in South Africa in recent times is a necessary, but by no means sufficient, precondition for increase FDI in the sub-region. If on the other hand, this does not happen soon enough, there will be an influx of workers seeking employment in South Africa from the surrounding countries. This will exacerbate the current unemployment levels in South Africa which are already above 45 per cent.

The option of trade and foreign exchange liberation and hence possible increases in capital outflows has two distinct advantages. First, it will have a tendency to reduce the influx of job seekers into South Africa as employment opportunities at home increase. Second, it will increase the production of goods and services, not only for the domestic market but also for the region as a whole including South Africa itself which at present is a very high-cost producer because of inflated wages and very high tariff structures which were meant to protect domestic industries. By the same token, Africa awaits the revival of the Nigerian economy so that it can act as a growth pole in the west of the continent.

The statistics are too fragmented to allow a comprehensive view concerning the role of foreign direct investment in SSA, in particular of multilateral corporations, and its effect in the exports of manufactures from the region. Nevertheless, some general observations may be possible. Gunning (1995) observes that it is not sufficient to have a satisfactory account of export-related FDI in developing countries and that additional explanation is needed as to why multinational operations can become optimal when previously exports from the foreign country consisted entirely of

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good produced by foreign firms. He suggests three possible explanations: changes in credibility, changes in labour costs and changes in transport costs.

As long as government policies are seen as credible by foreign investors – which may be enhanced by the provisions contained in a regional integration arrangement – they have an incentive to engage in long-term investments and enlarge the production bases. As for wages, Gunning (1995) quotes some evidence from Biggs et al. (1994) that recent policy changes in Africa, particularly the large exchange rate adjustments under structural adjustment programmes, have led to a substantial fall in labour costs, sufficient to make Africa competitive in the supply of garments for both regional and extra-regional markets. Whether this will attract FDI is yet to be seen empirically. The recent experience in Mauritius, however, shows that the situation may not be as rosy as it sounds as increased exports from developing countries often face quantitative restrictions in developed country markets. Another important step taken by a majority of African countries has been the introduction of liberalised currency markets as part of structural adjustment programmes. They have generally made it easier for multinational corporations to repatriate earnings. Though freer exchange rate regimes have increased the cost of foreign exchange, they have at the same time improved foreign exchange accessibility and reduced delays associated with the central banks' queues. A number of countries (e.g. Ghana, Kenya, Uganda and the United Republic of Tanzania) have implemented such policies.

Improved transportation between African countries as evidenced by the large investment in the transport infrastructure in SADC has two important implications. It increases the incentives for FDI to take advantage of the reduced transport costs and, of course, the larger market. It also increases the credibility of the region as a viable trade bloc.

Latin America has experienced a surge in intra-regional exports, particularly in manufactured exports as a result of regional cooperation. A notable feature of the increased intra-regional exports is that products which encounter a relatively high share of their demand in the regional market exhibit more complex technological characteristics than exports channelled towards extra-regional or domestic markets (Ffrench-Davis, 1995). This is consistent with Elbadawi and Ndulu's (1995) finding that FDI, because of the higher level of technology embedded, requires a higher level of educational attainment for it to be more productive and hence contribute to a higher level of economic growth. Elbadawi (1995b), while emphasising the point of regional cooperation and policy credibility, argues further that deeper economic integration in a given region could permit expansion of the regional economy to generate the threshold scales necessary to trigger

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the much needed strategic complementarity, and to attract adequate levels of investment for the development of modern manufacturing and the transfer of technology within the region.

From the research carried out by the UN Economic Commission for Latin America and the Caribbean (ECLAC) and quoted by Ffrench-Davis (1995), two main conclusions emerge:

(a) The production of goods which depend to a greater extent than others on intra-regional trade has more sophisticated technological features. Such goods are to be found mainly in the chemical sector, non-electrical machinery and transport equipment. They are also sectors in which international demand tends to be more dynamic. Their price trends are more stable and more positive over the long term than traditional exports, which over the years have faced wide fluctuations in world market prices.

(b) The sectors which exhibit a strong export drive toward the region also tend to show (sometimes with a lag) a drive towards extra-regional markets, which suggests that the promotion of intra-regional trade complements the promotion of extra-regional exports. Significant amount of effort has gone to promote intra-regional trade in the Southern African region by identifying obstacles and opportunities, e.g. trade facilitation in SADC and trade information network in COMESA.

The methodological and theoretical advances in the recent literature on development and economic growth and the lessons from the East Asian development strategies suggest the following broad ideas for African countries. Regardless of the trade orientation or the chosen development strategy, respecting fundamental macroeconomic balances and static efficiency rules on a sustained basis is an essential pre-requisite (Elbadawi 1995b). Intra-regional trade and investment flows can be raised in several ways.

First, in order to attract foreign portfolio investment, it is necessary to institute credible stock markets as well as develop new financial markets, a feature that is still rudimentary at best in most countries in the region. Several countries are currently engaged in setting these up but much still needs to be done in establishing the credibility of these markets and establishing the required confidence to operate in them.

Second, is the issue of the very large external debt overhang currently compounded by a growing overhang of public domestic debt. The uncertainty such overhang generates with respect to the stability of the macroeconomy in the future and contingent taxes to service it remains a major bottleneck to the confidence of investors and expected returns to portfolio investment. Unless a solution to this problem is arrived at, SSA countries will be hard pressed to position themselves to benefit from both direct and portfolio foreign investment.

A third factor, stressed by Fine and Yeo (1994) is that regional integra-

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tion may enhance FDI as foreign firms are attracted to a larger and better integrated market. As noted by Gunning (1995), this form of FDI is aimed at the domestic market, and not necessarily for the regional market although spillover effects into the region may occur.

A fourth channel through which regional integration could attract FDI is derived from applying specific set of assumptions to a popular model in the modern FDI literature (see Gunning, 1995). Assuming that multinationals consider producing abroad for export to the home market, Gunning shows that a combination of policy credibility, lower wages and transport costs could stimulate FDI. To the extent that regional integration in SSA achieves the above four requirements, it could stimulate export-oriented FDI.

In an attempt to determine the effect of FDI on intra-regional trade flows we use a model where the log of manufactured exports as a proxy for intra-regional trade flows is considered as the dependent variable. Total manufactured exports are used as a proxy for intra-regional trade flows because of lack of data on intra-regional trade in manufactures. By and large, manufactured exports are destined in the regional markets because they cannot compete internationally. We also use human capital development as exemplified by the level of secondary schooling to have direct effect on FDI inflows and hence on manufactured exports. The log of the product of FDI and secondary education is used as an explanatory variable to take into account the fact that FDI requires a higher level of human capital development for it to be more productive. The level of the countries' development as exemplified by GDP and GDP per capita is of course important. A decadal average of the ratio of FDI to GDP and the log of the decadal average of GDP were used as explanatory variables. We also use regional dummies to account for the fact that some regional groupings have benefited more from FDI than others and that this may have contributed to the increase in manufactures exports for the regional market.

Regression Equation

$$LMEXP = \alpha + \beta_1 FDIGDP + \beta_2 LFDISEC + \beta_3 LGDP + \beta_4 ECOWAS + \beta_5 CEAO + \beta_6 MRU + \beta_7 CEPGL + \beta_8 UDEAC + \beta_9 COMESA + \beta_{10} SADC + e$$

Variables

LMEXP:	The log of the decadal average of exports of manufactured goods.

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FDIGDP: The decadal average of the ratio of foreign direct investments to GDP.

LFDISEC: The log of the decadal average of the product of FDI and the ratio of secondary school enrollment to school age population.

LGDP: The log of the decadal average of GDP.

Regional Dummies: 1 if both countries belong to the regional grouping and 0 otherwise; ECOWAS, CEAO, MRU, CEPGL, UDEAC, COMESA, SADC

Method of estimation = Ordinary Least Squares.
Dependent variable: LMEXP.
Number of observations: 58.
The results of the regression estimates are shown below and are heteroskedastic consistent (HCTYPE = 2).

Regression Results

Variable	Estimated Coefficient	Standard Error	t-statistic
C	.840906	1.63327	.514859
FDIGDP	-29.1721	12.2756	-2.37643
LFDISEC	.754207	.230199	3.27632
LGDP	.125317	.300314	.417288
ECOWAS	.374098	.433009	.863948
CEPGL	.464306	.406814	1.14132
COMESA	.524989	.404388	1.29823
SADC	.643789	.424564	1.51635
CEAO	.725922	.240655	3.01645
UDEAC	1.08720	.484346	2.24468

Mean of dependent variable	= 7.18652	Adjustment R-squared	= .566159
Std. dev. of dependent var.	= .822012	Durbin-Watson statistic	= .602769
Sum of squared residuals	= 14.0711	F-statistic (zero slopes)	= 9.26494
Variance of residuals	= .293148	Schwars Bayes. Info. Crit.	= -.716242
Std. error of regression	= .541432	Log of likelihood function	= -41.2252
R-squared	= .634660		

With low and declining GDP growth rates, the ratio of FDI to GDP has been found to be a significant determinant of manufactured exports although with a wrong sign (see also Figure 2) which is a reflection of the declining GDP growth rate and increasing FDI. However, the log of GDP

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has been found to be insignificant in determining manufactured exports. This is inconsistent with earlier findings relating GDP growth rates to the growth in manufactured exports. A more striking result is the product of FDI and secondary schooling indicating that FDI, which embodies a much higher level of technology, requires a much higher level of human capital to enhance its productivity and contribute more positively to the growth in manufactured exports. It has further been observed that using a decadal average, the trend of manufactured export as related to FDI portrays an upward trend, though fluctuating, over the period 1970 to 1993 (see Figure 3). Dummies are used to take into account the various regional groupings.

For the regional groupings, preliminary results of the econometric estimation indicate that the ratio of FDI to GDP, the product of FDI and the level of secondary education as well as the log of GDP jointly influence the intra-regional flow of manufactured exports in CEAO and UDEAC with significant levels above 90% and SADC at 80%. These results are consistent with the results obtained in estimating SSA trade potential using the gravity model. It has been argued (Mistry, 1995) that within some common monetary areas and in regions where currency convertibility has been achieved, there is both current account convertibility and a fairly liberal capital account transfer regime, though the capital account transfer need not necessarily be within the regional grouping. If the above results are anything to go by, FDI, along with the other variable identified, seem to have significant influence in the increased intra-regional flows in manufactures and possibly cross-border investments in CEAO and UDEAC – two regions in a monetary union.

A general review of FDI entry procedures would not be sufficient without reference to the relevant sectors which also impinge on the approval process. For example, in all African countries, minerals and petroleum in the ground are the property of the State and no one can prospect, mine or produce them without a license. Besides having to comply with the basic requirements of the FDI legislation, investors in the mining and petroleum sectors therefore have to undergo additional approval procedures under the mining and petroleum laws of these countries. Such sectoral laws could, if not reviewed, in some instances defeat the purpose of new FDI laws.

A major benefit of RIAs in the developing world should be immediately seen through an expanded inflow of foreign direct investment into the region. Even in the European Union this effect has been pronounced initially vis-à-vis inflows from the USA, and more recently from Japan and East Asia. In addition, cross-border investment flows from within the region can yield significant benefits. To the extent that these two catego-

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ries of investment depend on the creation of a regional market, extra-regional FDI and intra-regional cross-border investment will both be influenced by the trade and production barriers, and by the hindrances represented by investment licensing. The removal of these barriers is a precondition for exploiting the gains from investment under RIAs.

Some investment incentives take the form of duty drawbacks or rebates; others take the form of tax holidays. Direct subsidies may also be used. All parties to an RIA have a legitimate interest in the incentives offered by the others, since these may affect the level and location of regionally justified investment in the bloc and thus also affect the direction of trade, and the distribution of the benefits of integration. If investment incentives are provided in the context of regional integration agreements, this should be done directly and openly, in a way that does not raise the price of products to consumers. If existing incentives could be shifted to such a basis, one of the major distributional obstacles to operating a customs union would be immediately overcome.

It has been argued (Mistry, 1995) that the constraints posed by non-tariff barriers to cross-border investment in developing regions are real. First, except within the common monetary areas, exchange control and investment licensing controls usually apply. Second, it is in the nature of developing countries that domestic capital is perceived to be short (when it is usually misutilised) and capital markets are generally under-developed. Finally, tax regimes are complex, the burden of business taxation is not uniform, and double taxation agreements among developing countries within a region are not very common.

Future external funding in SSA may require some degree of reorientation, for it to be more effective and these may include, among others: (i) a reorientation of donor funding with a more private sector orientation so as to avoid government debt overhang and to minimise donor fatigue; (ii) more efficient mobilisation of private foreign capital both direct and portfolio; (iii) aggressive mechanisms to attract African flight capital; (iv) more efficient means of mobilising and rechannelling personal remittances; (v) development of new financial institutions such as funds, venture capital, leasing, stock markets, women's finance institutions, rural banks etc.; and (vi) development of new financial instruments like guarantees, industrial funds, debt/equity swaps etc.

V Conclusions

In the past three decades, there have been several initiatives toward regional integration and cooperation in sub-Saharan Africa. However, while the need for economic integration received widespread support, both

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on pragmatic grounds and as a step toward African unity, very little progress has been made.

The main thrust of early initiatives was to promote preferential arrangements for intra-regional trade, so as to expand markets and reap efficiency gains from larger-scale production. This was considered to be particularly important for import-substituting industries. The first generation of such initiatives were unsuccessful for three main reasons: complementarity in production was too low to foster fruitful exchange; payment arrangements to circumvent the problem of inconvertible currencies were inadequate; and overriding concerns of individual countries with their own industrial plans made it difficult to arrive at an acceptable distribution of costs and benefits from the schemes. The collapse of the once successful East African Community was particularly unfortunate.

In short, integration efforts have been driven more by unrealistic political aspirations and bureaucratically defined blueprints than by their real potential. Despite over 50 regional organisations, there has been little actual economic integration. By and large, the successful cross-border networks of traders which have developed have done so more in spite of official policies than because of their support (Global Coalition for Africa, 1995).

Although intra-regional trade flows have been limited, the potential to increase such flows exists. Increased flows of FDI could foster enhanced intra-regional trade flows. Since most SSA countries have extensively liberalised their trade and payment mechanism, an enabling environment for FDI flows has been created with possible increases in cross-border investments. Investment liberalisation should be combined with other measures aimed at improving the investment climate such as investment promotion and protection; the strengthening of the general legal framework relating to business activities (including especially company law); and, in the light of the interrelationships between FDI, trade and technology, ensuring the consistency of their respective policy frameworks.

The results of econometric estimation point to the importance of human capital development for enhanced economic growth. This suggests that African governments should place special emphasis on education expenditures (particularly secondary and technical education) if past growth declines are to be reversed.

A striking feature of regional integration arrangements today is their expanded scope in terms of policy measures and diversity of objectives. In this regard, there is a window of opportunity for SSA to use regional integration as a supranational mechanism to foster policy credibility, and as a means to pool risks between otherwise vulnerable small economies; to resolve conflicts and minimise political risks; to exploit complementarities

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and to develop regionally-based links on a reciprocal and mutually beneficial basis.

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