FDI and Development

Desk-study on the Impact of Chinese Foreign Direct Investment (FDI) has in Angola's socio-economic development.

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Angola is an important FDI receptor, the second highest FDI inflows receiver in Africa. Its vast volume of oil, gas and diamonds have made of the country an appealing destination for Chinese FDI, whose rapid economic growth has lead to a rushing need for resources in order to feed the Chinese production. Since 2002, China's loan-for-oil deals with Angola have increased to the point of becoming China's top trading partner in Africa. Sino-Angolan relations present a growing complex interplay of benefits and challenges to reach development. This study focuses on the impact Foreign Direct Investment (FDI) from China has on Angola's socio-economic development, and whether this development is long-term sustainable. Based on the United Nations' definition of Sustainable Development, the indicators used to scrutinise the impact of FDI are: GDP, infrastructure development, corruption, unemployment, poverty and inequality rates, among others.

Results show that Chinese FDI brought economic growth and enabled fast infrastructure reconstruction, likewise market openness. Nevertheless, FDI has not lead to sustainable socio-economic development as standards of living barely improved; poverty is still widespread, as 36.6% of Angolan families leave below poverty line, unemployment rate remains high (reaching 25%), and corruption is prevalent. China's Aid assistance and infrastructure projects showed precarious consequences due to missing standards, poor quality work and lack of adaptability to local needs. Furthermore, market openness allowed the entry of low quality Chinese goods in the Angolan market, which besides providing a broad range of cheap products, harmed Angolan manufacture sector. Moreover, Angola's strong dependence on oil exports to China represents the great obstacle for Angolan sustainable development. In order to offset Angola's weak and dependent position over China and ensure sustainable development, Angola must work towards trade diversification and attracting investment from other countries.

1. Introduction

This paper sheds light on the process of economic and social development of Angola. In development, Foreign Direct Investment (FDI) is viewed as an efficient tool to generate wealth and boost the economy of the receiving country. Besides fast economic growth, recent studies suggest that it can carry countervailing risk. This paper suggests that FDI does not necessarily lead to a sustainable and long-term development. In a context in which FDI is increasingly orientated towards developing countries, whose perceive it as a tool for reaching sustainable development, I believe elaborating a study focused on the link between FDI and development is particularly reliable. The paper intends to answer the research question "does FDI bring sustainable social-economic development?" by analysing the second highest FDI receiver in Africa (Sandrey, 2009); the Republic of Angola; a developing country, oil and diamonds producer, ruled under a oligarchic system, which suffers from lack of infrastructure, high unemployment, and a conflictive social situation after a 27 year-lasting civil war.

In order to conduct the methodology, the paper uses the classic definition of *Sustainable Development* established by the United Nations Commission on Environment and Development in 1987; "Development is considered sustainable if it meets the needs of the present without compromising the ability of further generations" (WB, 2004, p.9). This definition embraces three dimensions; environmental, social and economic. The paper exclusively focuses on the social and economic. Hence, the indicators used for the analysis of Angola's development are GDP growth, poverty and inequality rate, employment rate, and corruption rate among others.

For the work, it is above all important to understand the concept of Foreign Direct Investment. FDI is defined as "an investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other that of the foreign direct investor (FDI enterprise or affiliate enterprise or foreign affiliate)" (UNCTAD, 2000, p.245). The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise, likewise a degree of influence and control by the investor over the management of the enterprise (OCDE, 2013). In order to consider an investment as FDI, it must achieve at least 10% of the voting stock and at least 10% of equity share in an enterprise operating in a country other than the investor's home country (UNCTAD, 2013).

2. Academic debate

There are two main positions in the current academic debate about the relationship between FDI and development. The dominant approach considers FDI as a key element for international economic integration that can lead to long-lasting economic development (OCDE, 2013). It defends that FDI opens international marketing networks and brings spill-over effects such as indirect knowledge, technological transfer, managerial skillsets, and innovation in the host-country (Narula & Driffield, 2012). According to the United Nations Economic Commission for Africa, "FDI is key to solving Africa's economic problems" (Mwilima, 2003, p.31). This argument is not commonly accepted, since recent research studies started to question the linkage between FDI and long-term socio-economic development.

The second approach argues the countervailing risks of FDI and how its benefits can be limited (Nunnenkamp, 2003). Development can only be reached when FDI is regulated by efficient public policies in the receiving country. Indeed, the host-country's government plays an important role to ensure spill-over effects reach the population and improve living standards (Loungani & Razin, 2001). Still, countries depend on their capacity of attracting FDI to have enough means to impose policy conditions regarding the inward investment (Nunnenkamp, 2003). Withal, less restrictive public policies induce less national management, which allow foreign investors to have major control over host-country firms; making of FDI a corporate governance mechanism (Loungani & Razin, 2001). In between these two approaches, our hypothesis inclines its supports toward the second academic approach as it suggests that FDI does not necessarily lead to a sustainable development.

3. Case study of Angola

Angola is an important FDI receiver, the second highest FDI inflows receiver in Africa (Sandrey, 2009). Its vast volume of oil, gas and diamonds have made of Angola an appealing destination for Chinese FDI, whose rapid economic growth has lead to a rushing need for resources in order to feed the Chinese production (Shinn, 2011).

In 2002 the civil war of Angola ended, its economy was going through a sever crisis, the conflict was still recent, institutions were weak and unstable, and unemployment and poverty were widespread (Bräutigam, 2010). Investment in infrastructure and boosting the economy were needed in order to foster business, as well as political stability. Hence, Angola applied for assistance to the international donor community,

by submitting the Poverty Relief Strategy Paper; it was rejected due to lack of consultation with relevant stakeholders during the paper's formulation (CCS, 2007). Shortly after, China offered a $2 billion (€1.6 billion) concessional loan "to fund the reconstruction of shattered infrastructure throughout the country" (Campos & Vines, 2008, p. 3). In 2004, the loan was made effective through the first installment and its implementation was divided into two phases, with $1 billon assigned to each phase. The first was released in 2004, and the second half was made available in 2007 (Campos & Vines, 2008).

In broad terms, the functioning of the loan was established to work as a current account; it requires the Ministry of Finance request, and the disbursements are made by EximBank directly into the accounts of the contractors and the repayment starts when a project is completed (Campos & Vines, 2008.). The arrangement allows deducting the servicing of the debt from the oil revenues (Campos & Vines, 2008). Moreover, 70 per cent reconstruction-related public tenders (tied to the loan) are awarded to Chinese firms; who clearly benefit as it provides employment for Chinese workers, facilitates oil extraction and creates business opportunities (Bräutigam, 2010).

The first phase of the project financed by the Eximbank amounted to 31 contracts, involving 50 projects on health, education, energy and water, agriculture, transport, social communication and public (Campos & Vines, 2008). Among all, the largest project was rehabilitation of a 371km long road between Luanda and Uíge. In the health sector, the focus was on rehabilitating and enlarging provincial and municipal hospitals, as well as district health canters. In education, the priority was on rehabilitation of schools, whereas the money in agriculture intended to improve the irrigation system and agricultural machinery (*Campos & Vines, 2008).* In 2007, the second phase of the loan was started, involving a total of 52 projects. The focus was on fisheries and telecommunications projects; "the acquisition of 36 large fishing trawlers and 3,000 boats for industrial and artisanal use, as well as 10 coast guard vessels" (Campos & Vines, 2008, p.15). In telecommunications, the investment was made in the construction of next generation networks, Internet protocol and intelligent networks across the country *(Campos & Vines, 2008*). That year, as a prolongation to the first phase of the loan, Eximbank provided an extension of $500 million, which intended to finance 'complementary actions' after giving an increase of $1 billion in 2006 *(Campos & Vines, 2008*). The impact of these loans brought tangible results in terms of infrastructure improvements (Davies et al., 2008).

Meanwhile, *China International Fund Ltd*, a private institution, extended $2.9 billion to aid the post-war reconstruction of Angola. The credit was entirely managed by the *Gabinete de Reconstrução Nacional* (GRN), Angola's Reconstruction Office created by President dos Santos, which was exclusively accountable to the President. Shortly afterwards, GRN projects caught the attention of the media for being inefficient, murky, and clearly corrupt. Moreover, the lack of planning, misleading and illegal arrangements resulted in many projects failing. The growing prevailing crony-client network was partly attributed to Angola's government mismanagement, which had been subject to weak monitoring mechanisms (Grimm, 2011). Until 2010, "transparent regulations and legal institutions enforcing property and contractual rights were lacking or underdeveloped" (Grimm, 2011, p. 3); allowing a prevailing crony-client network to gain control over the sources of state funding. These structural problems, jointly with budget mismanagement and out-of-proportion expenses (aggravated by the international crisis and a temporary fall in oil prices) raised external and internal debt (BTI, 2012). Despite the reduction in corruption, it remains pervasive and one of the major limitation for social development (Chêne, 2010).

1. Impact of FDI on socio-economic development

This section classifies positive and negative impacts, and examines if FDI leads to a sustainable development.

4.1. *Positive impact*

a) Sino-Angolan commercial relationship

The magnitude of economic impact FDI had on Angola's economy has been substantial when looking at the country's oil exports. Angola's oil exports to China has gone from 1 million of US$ in 2002, to 11 million of US$ in 2006 (CCS, 2006). In 2007, total bilateral trade amounted to 15.3 million of US$. In 2009, "oil comprised 95 per cent of exports and 85 per cent of government revenue" (Zhao, 2011, p.1). By 2010, the value of the Sino-Angolan commercial exchanges almost reached $25,000 million; China's imports from Angola reached $22,000 million (55% more than in 2009), while Angola's imports from China accounted for $2,000 million (16% less than in 2009) (BTI, 2012). In 2013, Angola's exports to China account for almost 50 per cent of total of Angola's goods exports (Hernandez, 2013).

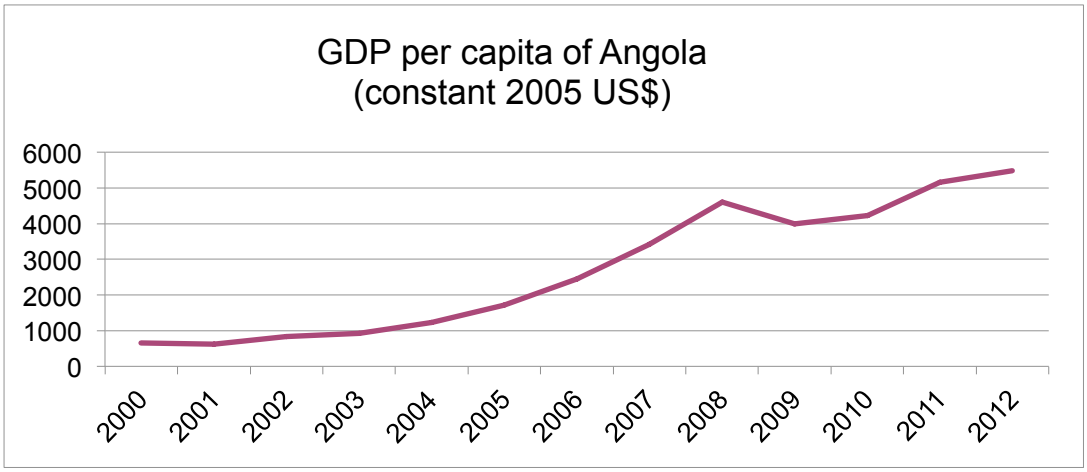
b) Market openness and access to low-cost manufactured goods

The improvement of Sino-Angola commercial exchange allowed low-price Chinese manufactured goods successfully spread across large part of the Angolan population. Moreover, the good's low-price made them accessible the poorest sector of the population (Osei & Mubiru, 2010).

c) Growth of GDP

The massive inward investment, jointly with increase in the oil sector and market openness increased Angola's GDP, which experienced constant growth from 2004 to 2008 [Figure 1]. The average of GDP Growth Rate has been of 10.72 per cent from 2000 to 2013. After 2008, GDP growth moderated due the Angola's financial structural crisis, aggravated by the global financial crisis. Apart from that, positive economic performance has been constant until nowadays. It is mostly attributable to the increase of oil production from new oil fields, but also to booming oil prices (IMF, 2006). The clear-defined pattern of the graph below shows an increase of Angola's production of goods and servises closely linked to China's involvemnet. Studies indicate that the economic opening has improved investment conditions of Angola (BTI, 2012). The number of foreign companies investing and operating in the country increased notably over the last years (BTI, 2012).

Figure 1. Angola's GDP (Current US$)



Source: World Bank, 2012.

f) Infrastructure

China's involvement has enabled a fast reconstruction of infrasturcture. The 2 billion US$ loans encompassed a total of 102 projects addressed to different sectors (Campos & Vines, 2008). Experts denaunceed that benefits of these contruction have yet been limited due to the lack of a fesaible organisation and low quality work (Benazeraf, & Alves, 2014). Besides the limitations, many of these contracts have

been successfully finished and in overall, the loans have brought tangible results in terms of infrastructure improvements (Davies et al., 2008).

4.2. *Negative impact*

a) Low impact on living standards

Despite of the economic growth, Angola is still one of the most unequal countries in the world and figures regarding poverty are distrubing (AfDB, et al, 2012). The profits from the oil industry have been concentrated into the hands of an elite, blocking the redistributive effect of gains from happening. Poverty Indicators such as the United Nations Development Programme (UNDP) Human Poverty Index, which measures the average progress of a country in human development, ranks Angola as the 89th out of 108 developing countries, whose HPI have been calculated (OECD, 2008). Moreover, "the UN estimates that 28 percent of the population is living in extreme poverty and another 40 percent are struggling to survive below the poverty line" (Sadrey, 2009, p.11). According to an "Inquiry into the Well-Being of the Population", conducted by the National Statistics Institute in 2007-2008, "36.6% of Angolan families live below the national poverty" (BTI, 2012, p. 3). In addition, GINI coeficient is 0.586 in 2009 (AfDB, et al, 2012); proving a high level of inequality. Moreover, experts agree that "the gap between the richest and poorest strata has been growing" (BTI, 2012, p.22). Much of the poverty concentrates in the agricultural sector; which accounts for eight percent of the GDP, while employes over 50 percent of the labour force (Sadrey, 2009).

b) Low quality Chinese construction and lack of adaptability to local needs

Chinese construction has been proved to bring serious problems due to its poor quality, cheap construction products and lack of adaptability to the population needs (Kabemba, 2012). Moreover, Chinese enterpises seem not to adapt their projects to the local context; In fact, impressive mega buildins such as out-of-portion stadios or the construction of a new stelite town, such as "the Kilamba Kiaxi flagship", a $3.5 billion project where nobody yet lives are clear examples of it (Benazeraf, & Alves, 2014). Last, the lack of qualified personal for new hospitals and schools reduces the potential use these public buildings could have (Benazeraf, & Alves, 2014). Therefore, housing and urbanisation policies should undertake more in-depth feasibility studies locally and drawing from international expertise" (Benazeraf, & Alves, 2014). These inefficiencies are both attributed to the Angolan government as well as the Chinese enterprises.

c) Corruption

Angola is rated as the 25th most corrupt country in the world (Transparency international, 2013). Despite of the implemented reforms in 2010 with regard to revenue and budget transparency, the overall legal and institutional anti-corruption framework remain highly insufficient and underdeveloped, lacking financial resources and technical expertise (Chêne, 2010). China's failure to condition loans on Good Governance misses the opportunity to reduce corruption and foster an efficient budget management. Angola continues to face major challenges of weak governance and widespread corruption at all levels of society, and this is a real hitch for Angola's development that needs to be solved (Chêne, 2010).

d) Decline of Angolan Manufactures

The entry of cheap Chinese products beside increasing consumption-related utility, brought challenging side effects such as a decline of domestic manufactures from 6.07% of the GDP in 2009 to 5.79% of value-added GDP in 2010 (New African, 2012). Sectors such as the clothing and furniture have been driven out of the market due to the unequal technological infrastructure (New African, 2012). Low investment, ill-advised industrial policies, rigid macro-economic frameworks and low diversification have hindered its competitive industrial capacity (Sandrey & Edinger, 2011).

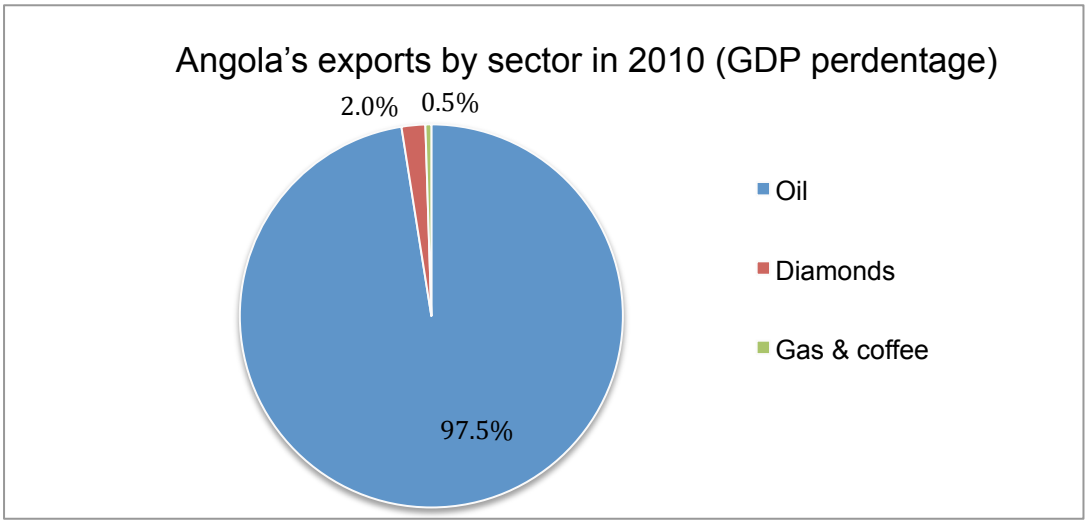
e) Unemployment

Despite the expectations on China's Aid projects, as an economic activity that would contribute to job opportunities, these predictions have not been met at all. Initially, it was established that 30% of the Chinese firms' workforce would be of Angolan workers, but this quota has rarely been attained (BTI, 2012). The justification of Chinese enterprises was the insufficient number of Angolan skilled workers. Despite of the decrease of unemployment rate since 2006 (35% unemployment rate), it has remained at 25% of unemployment since 2008 until nowadays (AfDB, 2014).

f) Lack of economic diversification

Angola shows a marginal degree of diversification in exports in which "oil represented 97.5% of the country's exports in 2010, followed by diamonds (2%) and gas and coffee (0.5%)" (AfDB, et al, 2012, p.7). This situation is fostered by trade with China, which accounts for 43.1% of Angola's exports (AfDB, et al, 2012). This dynamic encourages Angola to remain specialised in raw materials. It implies high vulnerability to commodity prices and external shocks (Renard, 2011).

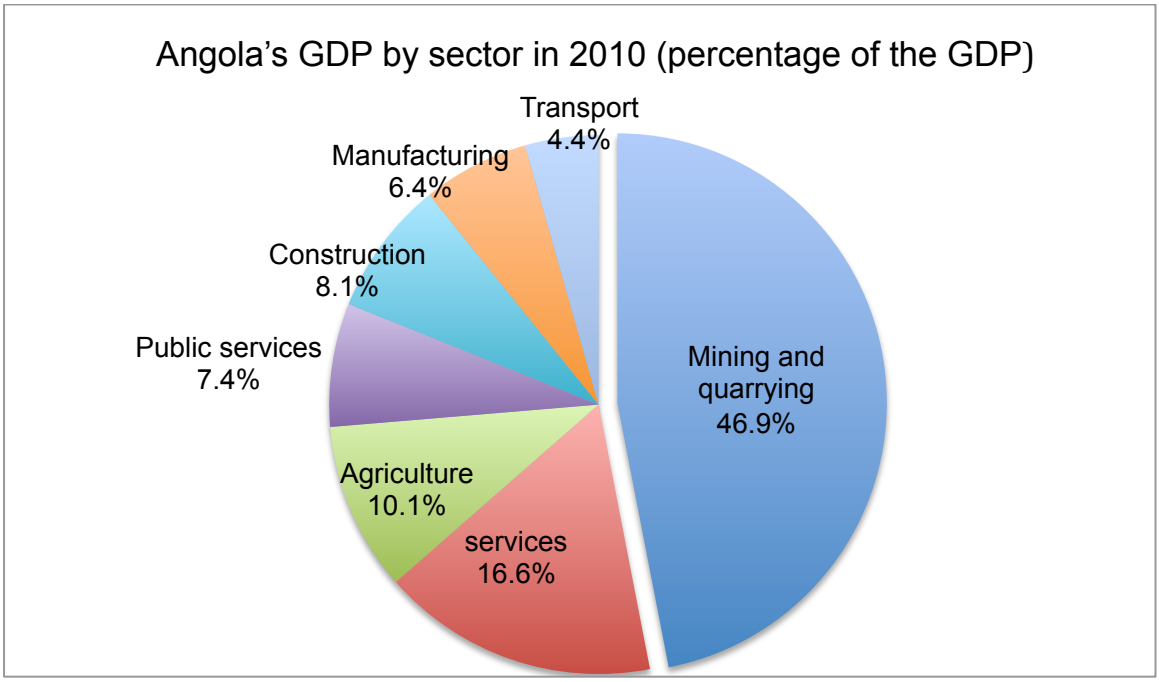
Figure 2. Angola's exports by sector in 2010 (percentage of the GDP)



Source: AfDB, et al, 2012, p.4.

Furthermore, a subsequent critical concern towards the oil industry is that it does not create equitable wealth; it enriches a minority while the majority falls into poverty. The figures regarding the country's diversification; oil and gas account for nearly 46.9 percent of GDP, while diamonds bring in another two percent (AfDB, et al., 2012). Recently, there has been a growing diversification of FDI that resulted in an increase of 7.7% in the non-oil sector, "which helped to offset the effects of production problems in the oil sector" (AfDB, et al., 2012, p.2). Despite of the efforts, Angola remains highly dependent on oil revenues.

Figure 3. Angola's GDP by sector in 2010 (percentage of the GDP)



Source: AfDB, et al, 2012, p.4.

5. Conclusion

The evidence confirms that impact of Chinese FDI on Angola's development is limited if not dubious. Although, FDI brought positive effects such as rapid rebuilding of infrastructure, economic growth and market openness, it has not promoted sustainable socio-economic development in Angola. First of all, infrastructure built by Chinese enterprises has generally been of poor quality and brought problems for its habitability (Benazeraf & Alves, 2014). Moreover, many of Chinese projects have failed to adapt to the needs of the local population and have excluded Angolan workforce and monitoring as part of the projects (Kabemba, 2012). Secondly, Chinese FDI has reduced the possibility of capital formation or job creation opportunity among Angolan population, which suffers from high rates of unemployment (AfDB, et al 2012). As result, unemployment rates remain 25% and despite of the slight decline, it remains a major challenge for reducing poverty. Thirdly, the entry of low-cost Chinese products in the Angolan market, harmed the Angolan manufacture sector, comparatively disadvantage (Sandrey & Edinger, 2011). Fourthly, Angola's current development is not long-term viable as it strongly dependents on oil export to China. This is the major limitation for a sustainable development, as it places Angola in a weak and dependent position over foreign Chinese enterprises (Loungani & Razin, 2001).

In order to confront this challenging situation, academics recommend African integration though regional trade agreements in order to boost Angola's trade diversification and improve their bargaining position, as well as attracting investment from other countries. In addition, major FDI diversification would also enable the country to establish its own policies and conditions, ensuring spill-over effects reaching their population. Moreover, it would be a positive step working towards a major level of government accountability and transparency, structural reforms and coercive public measures to ensure the reduction of corruption and foster wealth distribution.

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FDI & DEVELOPMENT

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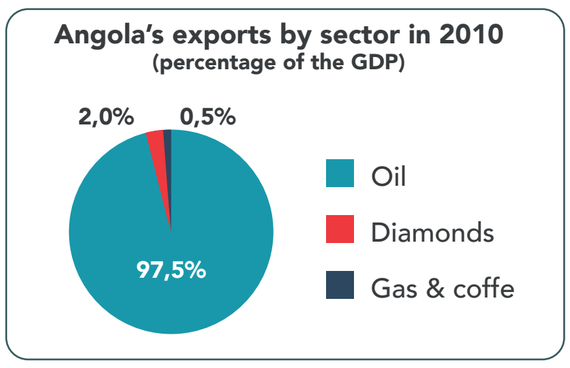
Desk-study on the impact that Foreign Direct Investment (FDI) from China has in Angola's socio-economic development.

RESEARCH QUESTION

DOES FDI BRING SUSTAINABLE SOCIO-ECONOMIC DEVELOPMENT TO ANGOLA?

INTRODUCTION

Angola has become the second highest FDI receiver in Africa. Its vast volume of oil, gas and diamonds have made of Angola and appealing destination for Chinese FDI. China's rapid economic growth has lead to a rushing need for resources in order to feed its production.



Source: AfDB, et al, 2012, p.4.

FOREIGN DIRECT INVESTMENT

FDI is *"an investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other that of the foreign direct investor (FDI enterprise or affiliate enterprise or foreign affiliate)"* (UNCTAD, 2000, p.245).

ACADEMIC DEBATE

Relationship between FDI and socio-economic development

1) The dominant approach: FDI is a key element for development. It promotes development through international economic integration, market openness, indirect knowledge and technological transfer, and innovation in the receiving country.

2) Alternative approach: FDI does not necessarily lead to a sustainable development. The host-country regulations play a reliable role ensuring spill-over effects reach the population.

METHODOLOGY

Sustainable development

established by the United Nations Commission on Environment and Development in 1987; *"Development is considered sustainable if it meets the needs of the present without compromising the ability of further generations"* (WB, 2004, p.9).

This definition embraces three dimensions;

- Social
- Economic
- Environmental

The indicators of socio-economic development:

- Unemployment rate
- Poverty and inequality rates
- GDP
- Infrastructure development
- Sino-Angola import/exports value
- Corruption rate
- Degree of economic diversification

(The paper exclusively focuses on the social and economic.)

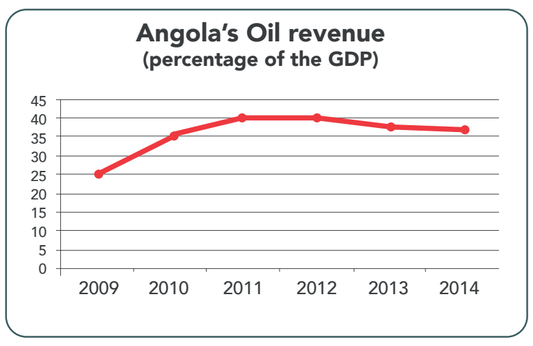
RESULTS

POSITIVE

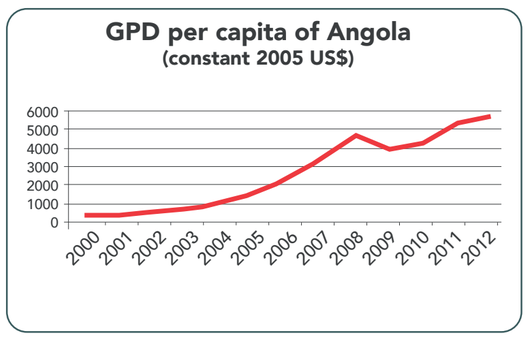
GDP Growth
Sino-Angolan commercial relationship
Market openness and access to low-cost Chinese manufactured goods
Fast reconstruction of infrastructure

NEGATIVE

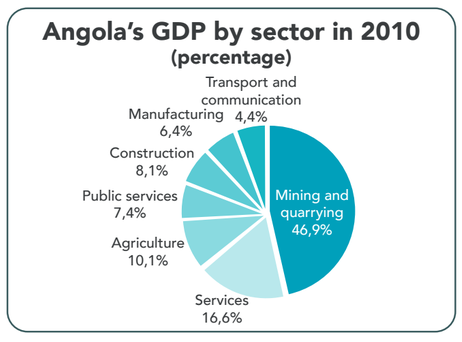
Low impact on living standards
Lack of economic diversification
Decline of Angolan manufactures
Poor quality Chinese construction and insufficient adaptability to local needs



Source: AfDB, OECD, et al., 2013.



Source: World Bank, 2012.



Source: AfDB, et al., 2012, p.4.

CONCLUSION

Chinese FDI has not brought sustainable socio-economic development to Angola.

Chinese FDI → **+ economic dependency towards China. - no tangible improvement of living standards.** → **No sustainable development in Angola**

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