# Africa's Burden: Labour Markets, Natural Resources and the FDI 'Reliance-Rejection' Paradox

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Development in sub-Saharan Africa has been one of the most disputed issues among development institutions and their detractors in the last thirty years. While the rest of the world has experienced relatively uninterrupted growth since 1960, SSA hasn't been able to follow this trend, and its importance in the world economy has persistently diminished – constituting 17% of world GDP per capita between 1960 and 1969 with a higher growth rate than East Asia, but only 9.9% between 2000 and 2008 (World Bank, 2009). In absolute terms, SSA's level of development has been declining in most countries, with 384.2 million people living with less than US$1.25 a day in 2005, compared to 202.1 million in 1981 (Chen & Ravallion, 2008).

This paper will argue that it is the *incompatibility* between colonial legacies and Structural Adjustment Programmes (SAPs), implemented since the 1980s by International Financial Institutions (IFIs), which has hindered development in SSA in the last three decades. Indeed, SAPs have created a system that relies on Foreign Direct Investments (FDIs) as the main source to finance the development of SSA. However, the structure of the African labour market and the resource-extraction tradition, both inherited from colonialism, respectively make SSA very unattractive for investors, and direct the few inward FDIs towards the resource-export sector. This focus on natural resources led to the formation of three vicious cycles – enclave economy, economic volatility and patronage – which trapped SSA in an FDI reliance-rejection *paradox*, leaving the continent with no possibility to finance its own development.

Although the conclusions reached by this paper will aim to respond to the broader sub-Saharan challenge, the specific cases of Zambia and Tanzania will be used to illustrate the argument – two neighbouring countries which had comparable colonial and post-colonial experiences that shaped their institutions in similar ways (van der Geest & Wignaraja, 1996).

Indeed, obtaining their independence in the early 1960s, both Zambia and Tanzania followed an import-substitution strategy aimed at providing 'self-reliance' and stability, as claimed by President Nyerere in the Arusha Declaration of 1967 (Nyerere, 1973). However, an unfortunate combination of events in the 1970s led to a sharp increase in both countries' public debts (Kapunda, 2005): the 1973 oil crisis coincided with the fall in the price of copper for Zambia (which represented 95% of its export earnings), and a major domestic food shortage and international increase in food prices for Tanzania (Raikes & Gibbon, 1996). Strong pressures from IFIs led to the implementation of a series of SAPs since the mid-1980s, which reshaped Zambian and Tanzanian economic systems, placing FDIs as the key to development.

Indeed, there are four ways for an economy to finance its development, as represented in *Figure 1*. However, domestic saving is almost non-existent in SSA, as the marginal propensity to consume is close to 1 at such stage of development, and foreign aid remains irregular and disorganised (Sundaram, 2011). Therefore, as the other main source of financing, public taxation and borrowing, was drastically restricted by SAPs to reduce public deficits through retrenchments in the public sector and privatisations, FDIs became the prerequisite to development (Tambwe, 1997). They were indeed seen as a ''more reliable source of financing'', capable of driving progress and providing ''access [to] superior technology'' (Sundaram, 2011 : 8). However, SAPs were implemented while ignoring the two main structural characteristics of SSA, both inherited from colonial times: the organisation of labour markets, and the resource-export tradition.

| | Private | Public |
|---|---|---|
| Domestic | Domestic saving | Taxation, public borrowing |
| External | FDI | Foreign aid, public borrowing |

Source : Adapted from OECDAfDB (2010) by Sundaram, 2011

*Figure 1*

Despite the fact that it is rarely recognised by economists, the structure of the labour market is the main cause of the unattractiveness of the sub-Saharan economy for investors.  The foundations of the current SSA labour market were established during colonial times, through the introduction of a formal wage labour market. In Zambia, British settlers decided to progressively reform the urban informal market by creating wage jobs in key towns, which initiated a phenomenon of strong migration from rural to urban areas (Taylor, 2009; Sundaram, 2011). However, the urban population increased at a higher rate than urban job creation, and most migrants ended up working in the informal urban market. The formal market was hence unable to replace the informal one, and both had to develop next to each other (ibid.).

SSA inherited a labour market characterised by a strong division between formal and informal markets, which was further exacerbated by the introduction of SAPs in the 1980s (Tørres, 1998). Indeed, the reduction of the public sector, one of the main policies suggested by IFIs to lower public deficit, implied large retrenchment programmes which were supposed to be compensated by job creation in the private sector through privatisations. For instance, only between 1994 and 1995, 47,000 jobs were eliminated in Tanzania under the Civil Service Reform Programme (van der Geest & Wignaraja, 1996). However, the ‘unknown’ in this equation was the extent of job creation in the private sector in response to privatisations, which turned out to be lower than job destruction in the public sector. This growing inability of the formal sector to provide employment to the population led to a constant growth of the informal sector, which constituted 25% of the SSA economy in the 1990s – 50% if the agricultural sector is considered (Gilbert, 1998). This has serious implications for foreign investment, as FDIs are only made in the formal market: from the perspective of investors, the sub-Saharan economy is 25 to 50% smaller than it actually is.

Furthermore, the SSA labour force inherited from colonialism lacks comparative advantages, as it is very unskilled, unproductive and costly (Taylor, 2009). The very poor health conditions shape the age composition of the population by drastically lowering its life expectancy. Hence, an important part of the labour force is formed of young people who start working at earlier ages instead of completing their education. In Zambia for instance, 53% of children enrolled in schools do not finish the primary cycle, while 75% of Tanzanian children do not enrol in secondary school (UNICEF, 2011). This results in a very unskilled labour force unable to respond to potential foreign investments that often require higher levels of expertise. Moreover, the restricted supply of skilled workers increases the costs of production, together with the high level of labour protection, which makes sub-Saharan labour force the least cost-effective in the world (Taylor, 2009).

As a consequence of this, the structure of the SSA labour market has kept investors away, who prefer approaching cheaper and more productive developing economies. In fact, since 1970, investors have never showed any significant interest in SSA, which attracted only 3% of world FDI in 2000-2008, and even less in 1990-1999 (figure 2). Hence, SAPs placed FDIs as the key to the development of an economy that was structurally incompatible with

FDIs themselves.

| Percentage | | | | |
|---|---|---|---|---|
| | *1970-1979* | *1980-1989* | *1990-1999* | *2000-2008* |
| **Share of world FDI** | | | | |
| **Developed economies** | 75 | 75 | 68 | 67 |
| **Developing economies** | 25 | 25 | 31 | 30 |
| Developing economies: Africa | 5 | 3 | 2 | 3 |
| Developing economies: America | 12 | 8 | 10 | 9 |
| Developing economies: Asia | 8 | 14 | 19 | 18 |
| China | n.a. | 2 | 8 | 6 |
| Economies in transition | n.a. | 0 | 1 | 3 |
| **Share of developing country FDI** | | | | |
| Developing economies: Africa | 21 | 10 | 6 | 11 |
| Developing economies: America | 47 | 33 | 31 | 28 |
| Developing economies: Asia | 31 | 56 | 62 | 61 |
| China | n.a. | 7 | 25 | 21 |

Source : UNCTAD, World Investment Report 2009 ; Sundaram, 2011.
*Figure 2*

The trouble with SSA inward FDIs does not simply lie in their small quantity, but also in their nature. The vast majority of investments are made in the natural resources extraction sector, which is extremely damaging for the African economy and originates from colonial legacies.

In fact, the main rationale behind colonialism was to exploit natural resources in foreign lands, as they were becoming always more scarce and expensive in Europe. Thus, resource extraction and export constituted the main activity throughout colonial times, and when SSA countries obtained their independence, they were left with no other sector of the economy having attained an acceptable level of development (Tørres, 1998). Zambia and Tanzania had only been exporting, respectively, ore and ingots, and tobacco, sugar, fruits, cotton, sisal and timber, and British settlers left them with no infrastructure – an essential prerequisite for investment (ibid.). Unable to produce what they needed, Zambia and Tanzania became entirely dependent on imports and foreign aid. As a consequence of this, import substitution strategies emerged in the 1960s and 1970s to promote the development of their own manufactural and industrial sectors (Nyerere, 1973).

However, when state-led ISIs failed, most manufacturing enterprises closed down and IFIs declared that investment would only be made through market allocation (Taylor, 2009). Since manufacturing and industrial sectors were almost non-existent and SSA was lacking basic infrastructure, foreign investors refused to engage their funds in the development of new sectors, and hence concentrated their efforts on the only activity that had previously been exploited – natural resources extraction.

Nevertheless, this sector provides extremely limited development opportunities and can be very damaging for a developing economy, as it does not provide advantageous transfers of technology, and the intrinsic intensity of such activity does not offer significant returns to labour – i.e., a more intensive extraction produces very little positive outcome for employment (Taylor, 2009 ; Sundaram, 2011). Furthermore, the high concentration of FDIs on natural resources led to the formation of a series of 'traps', which locked SSA in an FDI reliance-rejection paradox that hinders its development.

First of all, a phenomenon known as enclave economy or 'Dutch disease' made its appearance on the continent.

Natural resources are traded for foreign currency, which inflates the national currency and undermines the price-competitiveness of the other – still weak – sectors of the economy, whose production falls for both domestic and international trade (Collier, 2008). By crowding out key productive sectors such as manufacturing and services – which were the source of the East Asian fast development – Dutch disease contributes significantly to the stagnation of SSA. As a matter of fact, the GDP share of the manufacturing sector has been declining since 1980 in SSA, reaching 8% in 2000-2008 – 3.75% in Tanzania (ILO, 1995; UNCTAD). Therefore, Dutch disease led to the constant relative growth of a sector that does not contribute to development on a macro level, while crowding out FDIs in the productive sectors.

Secondly, rents created by resource extraction are extremely volatile, as they entirely depend on the fluctuations in world prices. This exacerbates the intensity of the business cycle, making SSA economies extremely difficult to manage: trivial and unproductive public spending is made during boom times, which are then compensated by further retrenchments during recessions (Collier, 2008). Thus, the positive growth rates experienced throughout the continent since 2000 can easily be linked to the recent boom in commodity prices, including a 300% increase in oil prices, while the 2007-2008 financial crisis and the associated decrease in commodity prices caused negative growth rates as African rents fell (Sundaram, 2011; Taylor, 2009). Nevertheless, investors are very sensitive to such economic volatility, and refuse to invest in the sectors that would make SSA economies more stable – first and foremost manufacturing.

Finally, the extraction sector allows the government and political parties to be financed to a large extent by the rents that it produces, rather than public taxation (Sachs & Warner, 1995). It becomes easier and more cost-effective for them to run their political campaigns through patronage and ethnic loyalties, rather than improvements in public services (Collier, 2008). Indeed, as public money emanates to a lower extent from the population, they are less likely to be reprimanded. However, this often leads to political and ethnic instability, which makes FDIs more risky for investors, and hence contributes to SSA's unattractiveness.

What stems out of this paper is a necessity to tackle SSA's structural problems, i.e., the organisation of its labour market and its exclusive focus on the resource extraction sector. It is hence strongly suggested that IFIs and African governments should design state-led investment programmes backed up by international aid, aimed at fostering education, healthcare, public services, and the private industrial sector. A particular focus on the transformation of domestic natural resources into final products and a shift to enhanced domestic financing would encourage the creation of more stable development opportunities, and would allow SSA to prepare its labour markets and industries for global competition.

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