International Journal of Science and Research (IJSR)
ISSN: 2319-7064
SJIF (2022): 7.942

Foreign Direct Investment and Risks in Asia and Africa

Md Mahbubur Rahman

Candidate, Doctor of Laws
Email: *mahbubsinfo[at]gmail.com*

Abstract: ***Foreign investors worldwide are interested in investing in developing countries in Africa and Asia. Currently, these two continents are still rich in abundant resources, both human and natural resources. This wealth is a large business and a significant opportunity for foreign investors to gain many profits. As a foreign investor, doing business in a foreign country requires awareness, consideration, and evaluation of risks unique to its environment. These necessarily involve knowledge of the politics, economics, legislation, and, of course, the social and cultural traits of the community. Investment projects are essentially subjected to various forms of risk that can have impacts on the performance expected by beneficiaries. Managing the operational risk of investment and capital project is crucial to the economic viability of many organizations. This study provides an exploration of the imminent risks foreign investor faces in developing countries, particularly in the areas of trade secrets, trademarks, copyright, patent and licensing, and how tax holiday, labor and capital return policies affect investment in the countries. Not only is it risky for foreign investors, but investment activities are also risky for developing countries that are investment targets, where many foreign investors take advantage of the weaknesses of their target countries to gain greater profits. Based on this, foreign investors can first consider information related to the risks of their destination country, and countries with developing economies expect to strengthen their policies to eliminate any potential loopholes for exploitation. This research examines the risk that foreign investors encounter in doing business in selected underdeveloped countries, especially as relates to Japanese investors. It analyses the constraints to effective implementation of best practices and international standards. This thesis therefore recommends that the global rules for trade and investment need to be improved and made to work better in support of level playing fields and an open, rules-based global economy, especially so as to discourage protectionist trade and investment.***

Keywords: Economic Globalization; Political Economy; Foreign Direct Investment FDI; Private Foreign Investment PFI; Bilateral Investment Treaties BIT; Investment Risks; Developing Countries; Less Developed Countries LDCs; Risk Management

1. General Introduction

1.1 Background of Study

According to the World Bank FDI Entry and Screening Tracker, since 2020, more than 24 developing countries have reduced investment restriction policies by increasing foreign share ownership limits, thereby opening access to foreign investment. Even though developing countries have carried out policy reforms to attract the interest of foreign investors, such as reforms focused on services and reducing restrictions on the service sector, in fact, thill many foreign investors who do not have an interest in investing in these countries are affected by several factors such as policy reforms. It still needs to consider the technological skills complement, and the funded projects in the country are likewise deemed deficient. Many foreign investors find it difficult to access markets in developing countries due to restrictions on foreign investment in specific sectors or government policies deemed not by world investment law or can be said to be unfriendly to the business world. FDI can promote economic growth, but this differs from developed countries, which limit foreign investment. National security is maintained, and infrastructure and information are kept because there is no interference from outside parties. The record shows that 70% of countries implemented FDI restrictions based on FDI Entry and Screening Tracker data in 2020. Over the past 20 years, more developing countries have liberalized their economies and lifted many restrictions on foreign investment.[1] According to UNCTAD's latest Global Investment Trends Monitor published on January 17, 2023, FDI to developing countries will fall by 9% to $841 billion. Developing countries in Asia felt the impact of this decline with a decline of 12%, but it can still be stable in Africa, Latin America, and the Caribbean. The decline in FDI to developing countries occurred due to uncertainty in the world economy, weakening investment interest. Foreign direct investment (FDI) flows to developing countries fell by 9% to $841 billion in 2023, according to UNCTAD’s latest Global Investment Trends Monitor, published on 17 January.[2]

1.2 Study on Asia

Even though in 2023, most developing countries in Asia will experience a significant decline in FDI inflows, these countries remain attractive destinations for foreign investors to implement greenfield projects. China reportedly experienced an 8% decline in FDI inflows. India also experienced a decline in FDI inflows of 47%. Despite the decline, China and India remain in the top five global destinations for greenfield projects. The Association of Southeast Asian Nations (ASEAN) also experienced a decline in FDI inflows of 16%. However, the report said that the Philippines, Indonesia, Cambodia, Thailand, Malaysia, and Vietnam were still attractive places for foreign investors to invest in these countries in manufacturing. In contrast to Asia, which has felt the impact of the decline in FDI inflows to developing countries globally, Africa will experience almost no change in 2023, which will have FDI inflows of $48 billion, which can be said to be only down by 1% compared to 2022. In 2023, some major developing economies in Asia saw significant declines in FDI inflows but remained attractive destinations for greenfield projects – when a parent company starts a venture in a foreign country by constructing new operational facilities from the ground up.[3]

1.3 Study on Africa

African countries did not feel a significant impact from the decline in FDI inflows because foreign investors still saw good prospects if they invested in African countries. North Africa has great potential in energy development, especially in solar power and green hydrogen production. The world is experiencing energy supply problems caused by the war between Russia and Ukraine and pressure on countries to decarbonize and switch electricity from fossil fuels to renewable energy. North Africa planned several mega projects, such as constructing a hydrogen plant and developing other new energy infrastructure. For example, in Nigeria, the United States is carrying out a mega project, namely the construction of a solar power plant with a capacity of 935 MW and battery storage with a capacity of 443 MWh for US$ 1.8 billion. Saudi Arabia is also building a reverse osmosis plant, which has a capacity of 300,000 m^3/day. Ghana also announced plans to shift its energy mix to renewable energy. In 2022, the report said South Africa plans a mega project, Green Hydrogen Africa, to spend US$ 10 billion. The economic and geopolitical fallout from the war in Ukraine (energy supply concerns) and the pressure on countries to decarbonize and shift power generation from fossil fuels to renewables (COP27) have seen increased investor interest in projects to shoo up energy security.[4]

2. Literature Survey

FDI is welcomed and actively sought by virtually all African and Asian countries. The contribution that FDI can make to their economic development and integration into the world economy is widely recognized. The worldwide drive for economic development produced its performance cult.[5] Africa is a continent of extraordinary heterogeneity, with countries that vary significantly regarding political stability, infrastructure development, and economic performance. This diversity presents a unique investment landscape, where some nations may present challenges while others boast favorable investment climates.[6] West African countries are currently engaged in trade and investment negotiations with the EU to make their economic cooperation of over three decades reciprocal within the context of an economic partnership agreement (EPA). They have followed a three-track approach to cultivating FDI. Apart from using BITs, they have, as the second track, engaged in preferential trade agreements (PTAs) that embodied investment protocols.[7] A detailed analysis of each country, industry, and opportunity is indispensable to harness the full potential of FDI in Africa.

Studies on China-Africa relations often criticize Chinese firms for violating human rights and neglecting their responsibility to protect the environment. Some authors have even accused "the Chinese" of neo-colonialism. As in other continents, profitable investment opportunities can be found. More recent studies emphasize the responsibility of the host governments to protect the environment and local workers' rights.[8] Asian economies have expanded rapidly since the 1980s due to globalization. One reason is FDI (foreign direct investment).[9] The South Asian economies started dismantling their centralistic planning and development model -an approach where economic growth is sought through stringent trade regimes and control of financial resources by the government- since the beginning of the 1990s in favor of the arms-length or the market-based growth model.[10]

3. Statement of Problem

Foreign investors looking to expand their business abroad are meticulous in making investment decisions, especially regarding the uncertainty of government policies in the countries. This study also focuses on identifying investment risks in developing countries. Over the past three decades, FDI has been the major component of capital flows since firms domiciled in one country have established foreign branches and purchased foreign firms. Indeed, FDI has become the prime engine to foster growth and employment in the industrialized countries, to facilitate the development of less developed countries (LDCs) and the restructuring and internationalization of formerly socialist or sheltered areas. It is therefore not surprising that a global race for foreign direct investment is taking place worldwide.[11] The relationship between investment risk and FDI can also be seen in another perspective, namely in the perspective of the host countries. In the neoclassical growth model, capital should flow from capital rich countries to capital poor countries because it should earn higher returns. This does not explain why the majority of FDI takes place among developed countries rather than flowing from the OECD to the developing world. One explanation for this paradox could be found in the high investment uncertaintity in LDCs.[12] FDI flows from developed nations into developing regions, and private investors from developed countries increasingly focus on assessing investment opportunities across a spectrum of developing nations. Private investors are well aware that these opportunities come hand in hand with a host of risks, each with the potential to impact their investment decisions significantly. The critical dimensions evaluated are the socio-political risks, including political stability, social unrest, and governance quality.[13] Moreover, economic factors such as currency volatility, market volatility, and regulatory stability are pivotal considerations in risk assessment. Additionally, legal and contractual frameworks in the host countries play a crucial role in shaping the perceived investment risks.[14] The inherent complexities in these selected countries often give rise to various social, political, and economic risks, presenting a challenging landscape for foreign investors. These risks encompass a broad spectrum, including political instability from unpredictable governance transitions, socio-political unrest, and the potential for takeover. Economic risks materialize through haphazard economic policies, such as sudden currency devaluations or arbitrary regulatory changes, which can detrimentally affect investors' financial interests.[15]

In conclusion, investments in developing countries often entail intricate challenges emanating from international investment laws and local regulations. African and Asian nations, in particular, offer substantial opportunities but are accompanied by unique risks. A comprehensive exploration of these challenges is imperative to enable investors to make informed decisions in the evolving global investment environment.

4. Aims and Objectives of the Study

The research on private investment is at a teething yet defining stage. Unlike what is operational, research on private investment and FDI, in general, should constitute a guide for thriving regulatory decisions and provide the basis for stakeholder interaction. In truth, however, this level of research has yet to be attained, especially in developing countries, and this narrative must change. Hinged on this, the aims and objectives of this study are to:

a) Describe why FDIs are more beneficial to developed countries and how developing economies can benefit from FDIs.
b) Show how FDI stimulates the deepening of globalization and its efforts in shaping a new world economic order.
c) Trace the performance of FDI since its evolution and how it assists with financing Less Developed Countries.
d) Discuss the measurement and risks of FDIs and the various forms that FDIs may take.
e) Reconcile the definitional difficulties posed by countries like Japan and France's inability to count retained profits in a foreign subsidiary as worthy of falling under FDIs.
f) Analyze the risk of private investment in developing countries, particularly Japanese investments, and propose a mechanism for managing these risks.

5. Methodology / Approach

The research carried out in this research is a library research method originating from primary and secondary sources. The primary sources are laws, case law, international conventions and international judicial body decisions while the secondary sources are textbooks, journal articles, and the internet.

6. Results & Discussion

ASEAN countries are known as countries with assembly operation capabilities, one of which is the production process and relatively low wages compared to other countries. Many foreign investors are interested in investing in the manufacturing sector in these countries. Southeast Asia can attract foreign investors in the manufacturing sector due to several factors, namely relatively low wage levels, local people who have special skills, and free access to Western and Asian markets. Wage levels in ASEAN countries are determined based on the country's productivity level; for example, Indonesia, the Philippines, Indonesia, Malaysia, and Thailand are ranked the most competitive in labor wages. Vietnam has also become an attractive place for foreign investors in the manufacturing sector, as Vietnam's market activity has increased significantly. In 2022, the report said that Samsung will invest US$2.25 billion in Vietnam because Vietnam has a good quality workforce, especially educated young people, broad internet access, and support from the Vietnamese government. For many years, the ASEAN region was mainly seen as a location for low-wage assembly operations. However, several significant factors now favor a re-assessment of these countries' roles in manufacturing.[16] Africa still needs to be in a situation that supports economic development. Infrastructure in Africa, such as electricity generation capacity, internet access, mobile broadband access, and adequate roads, still needs to be improved.

In 2022, the African Development Bank (ADB) reported that Africa experienced disruption in infrastructure investment of more than US$100 billion/year. It has a significant impact on local communities and global competitiveness. The government is making efforts to overcome this problem by prioritizing infrastructure development in Africa, such as transportation, electricity supply, education, and health infrastructure, which can have an impact on increasing the quality of the workforce in Africa, as well as improving information and communication technology (ICT) services. However, Africa still needs better governance, high levels of corruption, and many conflicts, which prevent foreign investors from entering the country and hamper the effective planning and implementation of infrastructure projects. However, despite the importance of infrastructure development in Africa, the infrastructure stock in most African economies is at least needed to support their required economic growth and development levels.[17]

6.1 Foreign Direct Investment FDI

Foreign Direct Investment (FDI) has witnessed remarkable expansion since the early 1980s, and the global FDI landscape has evolved into a highly competitive arena.[18] This burgeoning phenomenon can be attributed to several factors, including economic liberalization, technological advancements, and globalization. Developing nations, in particular, have emerged as increasingly alluring investment destinations, primarily due to their ability to provide a wide array of "created" assets, such as cost-effective labor, abundant natural resources, and burgeoning consumer markets.[19]

6.2 Inherent Element of Risks

In contrast to domestic investment, FDI carries higher risk and cost. Several factors contribute to this perception. Firstly, the information asymmetry regarding foreign markets raises uncertainty. Second, the sovereignty of host countries introduces additional complexities and risks. Navigating unfamiliar legal systems, regulations, and business environments can be resource-intensive and presents an inherent element of risk.[20]

The inherent complexities in these selected countries often give rise to various social, political, and economic risks, presenting a challenging landscape for foreign investors. These risks encompass a broad spectrum, including political instability from unpredictable governance transitions, socio-political unrest, and the potential for takeover. Economic risks materialize through haphazard economic policies, such as sudden currency devaluations or arbitrary regulatory changes, which can detrimentally affect investors' financial interests.

6.3 Unstable Trade Policy

In contrast to developed countries, which have stable trade policies to attract foreign investors to invest in their country,

Paper ID: SR24706012906 DOI: https://dx.doi.org/10.21275/SR24706012906

most developing countries have unstable trade policies and tend to be outside the line with FDI, one of which is policy in these countries. Africa. Policy instability can cause a lack of interest in FDI because investors think there is uncertainty if they invest in the host country, even though investors investing in the host country aim to work together with that country in the long term. Based on this goal, many investors are more interested in carrying out their investment activities in countries with policies and politics that can guarantee the protection of property rights and the implementation of democracy. FDI will invest if given ownership advantages such as patents, access to raw materials, brand names, management skills, and marketing skills. Ease of access to local markets is also one of the factors considered when investing in FDI because this can reduce production and transportation costs. Countries with stable policies and politics will be more open in trade relations. The unstable trade policies in African countries explain the low FDI flows to Africa.[21]

6.4 Political Instability

Political instability in developing countries poses a risk for foreign investors because there will be many acts of corruption and the creation of local bureaucracy, and the government tends to need to be more transparent. The need for more transparency from the government will make it easier for foreign investors to carry out their activities. Political instability can also create political conflicts and mass demonstrations in the country. Both of these things are a risk for investors because if there are mass demonstrations and terrorists, it will increase business operational costs with high insurance costs, increased security precautions, and increased growth in employee salaries. High levels of corruption and mass demonstrations in a country will create sudden changes in policies carried out by the government, especially economic policies, which may be detrimental to foreign investors. A country with stable macroeconomic, political, and legal conditions will have lower risks for foreign investors. Corruption makes local bureaucracy less transparent and thus discourages foreign investors.[22]

The nexus between political instability and investment risks is particularly noteworthy. Political transitions, whether due to elections or other factors, can create uncertainties regarding the continuity of favorable investment policies. Investors often ponder the implications of these transitions on their investments and the potential need for contingency plans.[23]

6.5 Security Challenges

The security of technological investments in developing countries is complex and multifaceted. It encompasses economic considerations and concerns related to national security, human development, and intellectual property protection. A comprehensive examination of these challenges is essential to facilitate a conducive environment for technological investments in developing nations.

In the realm of international business and investment technologies, the security of technological investments faces multifaceted challenges. While economic concerns are often at the forefront, it is essential to acknowledge that other significant factors, such as national security and human development, play pivotal roles in shaping the landscape of technological investments.[24]

These challenges are particularly prevalent in developing countries, where inadequate regulation and enforcement mechanisms raise numerous questions and create unique challenges for all involved parties. This thesis examines security issues within international business and investment technologies in developing nations within this intricate context.[25] One crucial dimension of these challenges pertains to the protection of intellectual property. Ensuring the safeguarding of trade secrets, trademarks, copyrights, patents, and licensing agreements is essential for fostering a conducive environment for technological investments.[26] The Protection of intellectual property rights dramatically impacts foreign investment and trade activities, which affect a country's productivity through technology transfer. This protection can minimize the risk of piracy. Thus, inadequate protection can prevent domestic and foreign investors from getting involved in technological progress, potentially hampering the country's economic growth.[27]

7. Conclusion and Recommendation

The prevailing negative image of the continent should be balanced with the multifaceted economic realities and investment prospects across its nations. By shedding this one-size-fits-all view and engaging in meticulous country-specific analysis, investors can fully realize Africa's vast potential and contribute to its economic growth.

Trade agreements are essential for countries to establish a framework for increasing trade and investment opportunities such as market access, employment issues, intellectual property rights, and environmental issues. Trade agreements aim to find problems that tend to be inefficient and whose solutions can mutually facilitate the benefits of various member countries. The rationale for trade agreements is economic growth based on the benefits of efficient production needed by other countries and private investment. Negotiations are carried out to ensure efficiency in guaranteeing ownership rights for the objects being offered so that the government has ownership rights over its policy instruments to secure property rights, such as market access through multilateral negotiations, and the agreement must be self-enforcing.

FDI can bring innovation to a country through foreign investors who want to access technology and knowledge to generate profits, which is the primary goal of investors.

This thesis therefore recommends that the global rules for trade and investment need to be improved and made to work better in support of level playing fields and an open, rules-based global economy, especially so as to discourage protectionist trade and investment.

8. Future Scope

Conventional growth standards not only measured success but also highlighted relative failure. While the cause-and-effect relationships at work here were the object of a great deal of controversy, the view generally prevailed that the influence of MNCs on economic growth, as conventionally defined, was positive in most countries where the scope of their operations was significant.

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Author Profile

Md Mahbubur Rahman, Candidate, Doctor of Laws. Researcher, International Law, Conflict, Peace, Security, Human Rights, Education and Political Economy. Former Advocate, Supreme Court of Bangladesh.

•• LLB Honours 1988 and LLM 1989. University of Rajshahi, Bangladesh. •• Diploma of Human Rights and Legal Aid 1994. - Higher Diploma of International and Comparative Law of Human Rights 1995. - Research Diploma of Economic, Social and Cultural Rights 1996. Dhaka International University, Bangladesh.

•• Diploma in Teaching Skills for Educators 2017. Ireland - TEFL, TESOL, Teaching English as a Foreign Language 2017. the U.K.

Email: mahbubsinfo@gmail.com

Permanent Address: House-418, Village - Loshkor, P.S. - Paikgacha, District – Khulna, Bangladesh Post Code-9280

Date: March 30, 2024.