African Bargaining Power with China

This book provides a detailed account of the political economy around investment deal negotiations between African governments and private Chinese investors.

The book draws on evidence from experiments and hundreds of interviews with policy makers and Chinese investors across Nigeria, South Africa, Kenya, Ethiopia and Tanzania. It shows that governments of authoritarian or one-party dominant states, which are among the top-receivers of Chinese investments, are able to easily and successfully act collectively to impose human capital and technology transfer requirements. The book argues that, rather than treating African countries as “price-takers” in the face of increasing Chinese influence in the continent, we should instead recognize the significant bargaining leverage that many African governments have to influence deal conditions, especially with smaller private Chinese companies. It demonstrates that several African governments can instead act “as price-setters” and that the success of the rising Chinese presence in Africa, and whether this leads to positive or negative development outcomes, fundamentally depends on the development strategies that individual African governments decide on.

In the context of an often-polarized debate, the original research presented in this book has important implications for the future economic development strategies of African countries. As such, it will be of interest to researchers working on Chinese and African investment, politics, institutions, business, economics, and international relations.

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African Bargaining Power with China
Foreign Investment and Rising Influence

Christina Seyfried
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1 African Bargaining Power
An Introduction

1.1 Introduction

Imagine that four development experts sit at a round table and discuss how African countries could not only attract larger amounts of foreign investments, but also request more local benefits from investors for their economies. The first one to speak is a dependency theorist:

The problem is that African countries are weaker members of a capitalist world order and are being structurally exploited by the West. No investments, skills or technology will come unless the stronger members of the Global North deliberately start to share them.

The second expert, a neoclassical economist, interrupts: “Investments, skills, and technology transfers will eventually flow in, but they can't be forced now. Countries need to continue to deregulate, privatize, and liberalize. They must make their countries more attractive to investors.”

The third one, a poverty trap specialist, speaks up:

No, the key issue really is that many countries in the African region have such weak institutions that even with reforms, no investor will want to come. And because there is no capital coming in, they can also not build stronger institutions. So, all that can really help us to break that cycle is foreign aid.

Finally, the fourth one – an experimentalist – concludes:

That also means we first need to get rid of poverty that exists due to market imperfections and government failure. So, let's focus on identifying causes of poverty at the micro-level, estimate the effects of different policies, then evaluate their cost effectiveness and take it from there.

What the four experts have in common is that they all essentially portray the majority of African countries as price takers. Many are too poor to attract the significant amounts of foreign capital needed for growth, and resource endowments are also too similar to build competitive advantages. There are also simply

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too many endemic economic and political issues at the micro- and macro-level that need to be solved first in order to appeal to investors that are interested in high returns and political stability. So, many African governments ultimately have to agree to whatever deals potential trade and investment partners ask for if the region’s goal is to attract foreign capital and develop.

This sentiment is also visible in the questions that scholars have asked about the relationship between Africa and China. For example, is China solely interested in oil and other natural resources? Will China trap African countries in debt? Is China only bringing in Chinese workers and exploiting the region? Or will Chinese companies in fact introduce manufacturing and develop Africa? This somewhat one-sided perspective of China’s strategy implies that the African region is a rather passive unit that can essentially only be a price taker of global economic and political power dynamics. Many African countries can then, seemingly only through the goodwill of an external player, either stay behind or prosper.

Surprisingly then, we observe that some African countries with relatively low bargaining power – with bargaining power defined here by economic and political structural variables that are less replaceable by exit options for the investor – ask private Chinese investors to contribute more toward developing local content, and that Chinese investors tend to, in fact, accept these stricter deals (Figure 1.1).

For example, in 2008, Zimbabwean President Robert Mugabe signed the Indigenization and Economic Empowerment Act into law. The act required 51 percent control by locals in the major sectors of the economy and was first adopted in 2006 for the hydrocarbons sector and later expanded to all sectors. Similarly, against a massive outcry from Western and especially French investors, the Algerian government adopted 51 percent local ownership in all companies in its 2007 investment law reforms. These laws were blamed for Zimbabwe’s and Algeria’s inability to attract foreign investment. Indeed, Figure 1.1 shows that US investments significantly decreased in both countries after they had strengthened local participation requirements on foreign investments. Yet, interestingly, Chinese investment stocks in Zimbabwe have in fact dramatically increased since 2010, so after the regulations were set in place.

These developments are also visible in other countries around different types of policy shocks. For instance, the Ethiopian government developed its famous comprehensive industrial policy in 2002/03 and introduced local content requirements in manufacturing industries and limits on the employment of expatriates, where companies applying for investment permits must provide a time schedule for the replacement of foreign employees by Ethiopian employees in addition to training programs. As Figure 1.1 shows, US investment stocks in Ethiopia dropped while Chinese investment stocks heavily increased after 2002.

In Angola, US FDI stocks grew until 2011, when the government was about to enact a new foreign exchange law in 2012, requiring the petroleum industry to channel all payments through the local banking system, and later, in 2015, a new investment law that would raise taxes on early repatriation of profits and dividends for foreign companies and create disadvantages for foreign investors relative to domestic investors by imposing local partnership requirements for foreign
investment in several key sectors (US Department of State Investment Climate Statements 2017). Chinese investment stocks, meanwhile, steadily increased.

In Madagascar, US investment stocks only picked up when the government introduced the Investment Law 2007-036, allowing foreign investors to hold up to 100 percent of shares of stock in the company in which they carry out their activities, except for in the telecommunication sector, where shares of the foreign companies could not exceed 66 percent. At the same time, Chinese investments have been growing at a fast rate in Madagascar since 2003.

Finally, in Tanzania, US investment stocks never picked up and have been stagnating since 2016, when the government began to encourage the hiring of Tanzanian citizens over foreigners, and to protect local industries. In particular, Tanzania enforces limits on expats, where companies are required to present a transition plan for training locals. In addition, the country has also increased tariffs

![Figure 1.1 Comparison of US and Chinese Investment Stocks Over Time.](image)

UNCTAD US Investment Statistics, CARI Investment Data. Please note that UNCTAD data on US Investments was only available until 2012, while CARI data on Chinese investments was available until 2017.

(Continued)
and import and export bans. Despite these regulations, Chinese investments appear to keep flowing steadily to Tanzania.

Over the past two decades, a rapidly increasing share of these Chinese investments in Africa stems from private Chinese investors that are only incorporated on the continent and part of the third wave\(^1\) of Chinese engagement in Africa. These companies are indirectly driven out of their own country due to China’s industrial saturation, and look for production and consumer markets in Africa. McKinsey (2017) estimates that there were more than 10,000 Chinese-owned firms operating in Africa in 2016, of which 90 percent were private.

In light of the odd Chinese investment patterns across Africa and the emergence of Chinese private players that account for a rapidly increasing share of total Chinese investments, this book asks: How much bargaining power do African economies have today with this new type of investor? What explains variation in government strategies around private Chinese capital? And finally, could some
African governments be asking more from private Chinese investors than canonical development theories suggest?

The central argument of this book is as follows: The top recipients of private Chinese investments, seemingly paradoxically, have significant bargaining power due to changes in the global economic and political environments. While African governments often face a lack of exit options due to a scarcity of different investors to choose from, the theory developed here shows that Chinese investors have placed more value on creating a new investment pie (however small) with an additional African country rather than investing the same amount in a country with existing investment stocks. The political benefits for China of entering new markets, therefore, outweigh the costs. I show that private Chinese capital first moves with politically motivated Chinese investments but, once on the ground, stays rather immobile. As a result, even African countries with small structural endowments have received a minimum amount of private Chinese capital – and countries with larger endowments have received substantially larger amounts – around which there is surprisingly substantial space to ask for local ownership and employment requirements.

I further argue that commonly cited variables such as corruption are insufficient direct causal explanations of the variation that we observe across government strategies. Instead, this book shows that before such factors come into play, some African governments are more aware of their bargaining power with private Chinese investors than others.

The argument is based on statistical analysis of investment data; the findings from 218 interviews that I conducted with government officials and Chinese companies across five country case studies over the course of 15 months; as well as on two complementary conjoint experiments that I designed and implemented with the Nigerian government and Chinese companies in Lagos and Ogun State in the spring and summer of 2020. The results of the research demonstrate that there are three components that determine governments’ perceptions of bargaining power: first, the extent to which countries have been exposed to local participation policies before; second, the extent to which the Weak Bargaining Power Narrative has penetrated their countries; and third, the extent to which countries are able to collect information about the number of Chinese investments flowing into their economies. If conceptualized as a game, I demonstrate that the first two questions concern information that political actors receive about the game, while the third one is about incentives to share or not to share information with other political actors within the game.

Overall, this book shows that, perhaps counterintuitively, governments in competitive democracies (e.g. Nigeria and Kenya) have lower perceptions of bargaining power because parties’ short-term ruling horizons as well as stronger historical relationships to the West have led negotiators to receive inaccurate information about their bargaining power with private Chinese players. In addition, the de-centralized nature of these competitive democracies – with de-centralization defined by weak parties and/or de facto weak centralized institutions – has also incentivized different domestic actors to compete for foreign investments across federal ministries and between federal and sub-national levels rather than to share
information on investment inflows and work on a common strategy. The ruling government is then unable to collect accurate information on investment inflows, which in turn influences their perceptions on bargaining power to be lower than their actual bargaining power.

In contrast, governments in one-party dominant systems or authoritarian regimes with long-term ruling horizons (e.g. Ethiopia or Tanzania) have higher perceptions of bargaining power because parties’ long-term ruling horizons as well as closer relationships to the East led negotiators to receive more information on Chinese investment patterns and to test stricter local content policies. Additionally, the centralized nature of these regimes – with centralization defined by strong parties and/or de facto strong centralized institutions – has enabled ruling powers to control the system and gather information on Chinese investment inflows that, in turn, influenced perceptions on bargaining power to match their actual bargaining power.

Finally, South Africa is a hybrid case with a one-party dominant system and de facto centralism but closer relations to the West, where the government has learned from experience that companies interacting with the government will follow its B-BBEE (Broad-Based Black Economic Empowerment) regulations, but also where Western economic thought has led the government to deem their bargaining leverage with private Chinese players that do not interact with the government to be low.

The main contribution of this piece is the finding that several African governments can, in fact, act as price setters around local participation with private Chinese investors, and that perceptions of bargaining power fundamentally matter for investment deal outcomes. Questions such as: “Will China exploit or develop Africa?” are therefore misguided. Instead, this book illustrates that whatever China-Africa story will be told in the future fundamentally also depends on what stories individual African governments choose to write – as they do have substantial space here to be narrators.

1.2 Defining Private Chinese Direct Investments in Africa

In this book, the term “foreign direct investment”, also for the purposes of readability simply called “investment” or “FDI”, is used to denote any capital movements in which an entity from one country directly controls the enterprise in another country in which the investment is made.2 I purposely focus only on Chinese investments – as opposed to Chinese loans and trade – in Africa. China-Africa studies often analyze Chinese loans, grants, and investments together under the umbrella terms “Chinese development finance”, “financial support” or “aid”,3 or focus predominantly on trade or loans.4 This is because China as a non-OECD (Organization for Economic Cooperation and Development) member is not bound to report its official aid. Chinese engagement in Africa is consequently often more opaque than Western nations. This has led the media and data collection initiatives to sometimes conflate and confound different forms of Chinese engagement in Africa. In addition, the Chinese government itself promotes holistic cooperation with Africa. For example, at the triennial Forums on China-Africa
Cooperation (FOCAC), China has consistently offered grant, loans and investment packages that suggest the existence of one bundled development strategy. Finally, China is Africa’s largest trading partner and is already competing with the World Bank in loan volume in the African region.\(^5\) At the same time, Chinese investments are still a relatively small part of China’s overall engagement in Africa. A whole strand of literature is therefore concerned with Chinese and Western infrastructure loans to Africa, perhaps most famously with infrastructure deals, and the origins and implications of deal conditions in Chinese contracting work around these infrastructure projects (e.g. Soulé 2019). In contrast, academic literature focused on Chinese investment in Africa is at best “thin” (Bräutigam et al. 2015, p. 2).

A growing body of literature distinguishes between different forms of Chinese foreign direct investment. Kaplinsky and Morris (2009) suggest four ideal types of overlapping Chinese investors in sub-Saharan Africa: central government state-owned enterprises (SOEs), provincial government SOEs, private sector incorporated in China, and private sector incorporated in sub-Saharan Africa only. My interviews with all sub-types confirm He and Zhu (2018)’s findings that Chinese companies in Africa are heterogeneous in their motivations and behavior: SOEs are generally operating under the strong control of Chinese central or provincial governments, and are driven by economic incentives, but also by the diplomatic relationship between the respective African country and China. As a result, they do not necessarily prioritize profit maximization and tend to be allowed to operate at razor-thin margins. In contrast, big private companies that are incorporated in China (e.g. Huawei) tend to be mostly driven by economic incentives, and aim to compete with Western companies in Africa. Still, due to their size and profile, they cannot completely eschew the Chinese government’s directives.

Finally, there is a last and rapidly growing subset that this book focuses on: private Chinese companies incorporated in the African region only, exclusively driven by economic incentives and able to keep a low profile (Feng and Pilling 2019, Sun 2017). They are generally located in the manufacturing and service sectors, and typically enter African markets through one of two channels: Chinese workers would travel to Africa through a Chinese SOE and later venture off to start their own companies in search of larger profits. Otherwise, private entrepreneurs in China would contact their friends in existing private Chinese companies that have already settled in an African country and ask them where to invest. This decision-making process is surprisingly quite independent of the political strategy of the Chinese government. McKinsey (2017) estimates that there were more than 10,000 Chinese-owned firms operating in Africa in 2016, of which 90 percent were private.

Despite the growing presence of this new player on the continent, we have surprisingly very little grasp on African governments’ responses to these new companies. In order to fill this gap, this study includes all capital flows of these Chinese private entities that invest across all sectors, in all forms, including the opening of a subsidiary or associate company in an African country, acquiring a controlling interest in an existing African company, or establishing a merger or joint venture with an African company. Understanding what relationships governments engage
in with these relatively new players on the continent and how these relationships could be optimized for the African side is the core task of this book.

1.3 The Outcome Variable – Deal Quality

I define the quality of investment deals by the degree to which they address the transfer of economic rent from foreign investment to domestic factors of production and consumption (following Globerman and Shapiro (1999) who only focus on production). In particular, I consider all policies that address domestic revenue mobilization and developing local content such as ownership, employment, taxes, license fees or property rights, among other variables.\(^6\)

That countries once deemed “price takers” did ultimately write their own development strategies is visible from other examples, like, most famously, China itself. From today’s perspective, it may seem a bit difficult to believe that before China started its market reforms in 1978, its economy actually performed worse than those of countries of the African region. China’s GDP/capita was less than one-third of the average in sub-Saharan African countries. In fact, in 1980, only Guinea-Bissau and Uganda’s GDP/capita were lower than China’s. Like many countries in the African region, China had high birth and death rates, low primary school enrolment, and very little infrastructure. Yet, fast forward 40 years, and the picture has changed dramatically: China is now the world’s second largest economy and the world’s fastest-growing consumer market. In 2018, per capita income in the African region ($1,589.2) was only about a sixth of that in China ($9,770.8), with only Equatorial Guinea, Mauritius and the Seychelles’ economies performing better than China’s.\(^7\)

Surely, in the late 1970s, development experts also knocked on China’s doors and offered their advice? Neoliberal economists tout China’s market-oriented reforms post-1978 and the establishment of property rights that attracted foreign investment as responsible for its long-term growth (Zitelmann 2019). State-centered scholars stress the autonomy of the Chinese government and its strong involvement in the economy that welcomed foreign investors to certain sectors as the key to development (Yao 2010, Oi 1992). Finally, a third approach combines the neoliberal and the developmental model to argue that an appropriate mix of the two led to China’s growth (Montinola et al. 1995).

China certainly worked hard on providing a conducive environment for growth. But there is something that these debates on China’s enabling policy environment overlook: While China did listen to some advice from development experts, the government also maintained a set of equity caps, joint ventures restrictions, and Chinese national leadership requirements that, in fact, imposed significant costs on investors and that have been exceptional across countries’ FDI regimes.\(^8\) Yet, despite these costs, China has been boasting the largest amount of FDI inflows of all developing countries since 1996 (UNCTAD 2012). Why was China able to impose such restrictions without losing out on valuable foreign capital? Investors must have been willing to take on the costs of domestic revenue mobilization and developing local content in exchange for China’s cheap labor in the manufacturing sector and, more recently, for a large consumer market. Simply put, China possessed bargaining power with Western investors.
And China actively used this power to grow at a pace that has been unparalleled in the world. In fact, China’s economy emerged so fast that it had amassed large amounts of foreign reserves by 2000 and decided to invest the money abroad, including in the African region. And its involvement on the continent over the past two decades has certainly been impressive: In 2018 alone, China and Africa traded a grand volume of US $185 billion. Between 2003 and 2018, Chinese FDI stocks in Africa increased from US $0.49 billion to US $46 billion, and from 2000 to 2018, China extended US $148 billion in loans to Africa. These financial contributions have certainly been driven by geopolitical considerations, but also reflect China’s growing demand for resources (e.g. oil, gas, copper or uranium) and export markets, as well as a push for Chinese infant corporations to expand overseas. With a significant slow-down in US involvement in Africa over the past years, China is already Africa’s most important trading partner, and set overall to become the continent’s most important economic partner in the near future.

How have different African governments met foreign investors — including private Chinese ones — with their foreign direct investment regulations, and how varied have these approaches been over time? Starting with Soskice and Hall (2001), the Varieties of Capitalism literature has been primarily designed with a view to developed economies, with very limited applicability to the African context. A few studies have attempted to identify the extent to which varieties of capitalism imported from colonial powers have fashioned today’s African economies (Vogel 2011). Indeed, during the Cold War, different ideologies including Marxism, socialism and capitalism spread through the African continent and impacted growth trajectories. This was documented for example by Crawford (1982), who studied ideological importance for the performance of African states in economic growth, distribution, self-reliance, human dignity, participation, and societal capacity. Bates (1981)’s work on inefficient state intervention in the agricultural sector in tropical Africa then led to increasingly louder calls to “deregulate, privatize, and liberalize”. With the end of the Cold War that further symbolized a victory of democracy and market capitalism, structural adjustment programs finally spread through the African region in the 1980s and 1990s. Overall, a general impression may have therefore emerged that the way capitalism has been practiced in post-Cold War Africa has been rather homogenous across individual countries.

Interestingly, however, and against the prevalent advice from Western development experts, some African countries did in fact develop regimes that meet foreign investors more aggressively than others, especially since the start of the 21st century. For example, the Ethiopian government formulated an Industrial Policy Strategy (IPS) in 2002, and as part of its Investment Proclamation, asked for local content requirements in the manufacturing industries and imposed limits in the employment of foreign staffers (excluding managerial positions), where foreign companies had to provide a succession plan for foreign employees by Ethiopian nationals in addition to training programs. While Tanzania started to borrow from the IMF in the mid-1980s and the first market-oriented investment code was introduced in June 1990, its foreign investment policy framework has remained relatively strict and become increasingly aggressive on raising revenue, on hiring of Tanzanians and on protecting and growing local industries since the election of
President John Magufuli in 2015. Moreover, South Africa’s Broad-Based Black Economic Empowerment (B-BBEE) regulations around black ownership and employment are yet another example that emerged out of a need to rectify the racial inequalities that the apartheid era had produced up until the 1990s, and that are still strictly enforced with domestic and foreign companies today. These cases suggest that developing countries can also pick “varieties of capitalism” as part of their overall development strategy.

Figure 1.2 summarizes the scores from the “Deal Quality Index 2020” Index that I developed based on US Department of State Investment Climate Statements on 44 African countries and that focuses specifically on local ownership and employment regulations. The benefit of this index is that it captures both formal and informal policy regulations. Higher scores indicate more aggressive policies,

![Figure 1.2 Deal Quality Index](image)

*Figure 1.2 Deal Quality Index.*

Index developed by author, based on local ownership and employment policies outlined in the US Department of State Investment Climate Statements 2019/20. The index accounts for both formal and informal regulations, as indicated in the statements. Higher scores reflect stricter local ownership and employment regulations while lower scores describe more investor-friendly policies.
and lower scores indicate more investor-friendly policies. As Figure 1.2 shows, how African governments strategize around foreign investment varies quite substantially. Why is that the case? Below, I discuss several theories that attempt to answer the question.

1.4 Existing Explanations For Variation in Deal Quality

Why are private foreign investors interested in developing economies? Neoclassical growth theory assumes that developing countries should grow at a faster rate than developed ones. As Gerschenkron (1962) famously noted, this is because developing countries have an “advantage of backwardness” – they can import technology, industry and institutions at low risk and costs; have low capital-labor ratios, which should increase the return on investment holding everything else constant; and can sell products on the domestic and global market. This translates into both cheap production and access to new markets. (Boddewyn and Brewer 1994).

On the other hand, governments have incentives to provide at least a minimum level of economic growth and employment to their population as means of gaining “consent from the governed” (Lipset 1983, Dahl 1971, Locke 1689). Given their low stocks of technology and capital, however, developing countries are often unable to kickstart “catch-up” growth without external sources of capital (Sachs et al. 2004). Foreign investment is therefore an attractive solution to supplement domestic savings; to access new export markets; and to induce technology and human capital development that arise from technological transfers and trainings. (UNCTAD 1995, Stopford and Strange 1991).

Bargaining power is often loosely defined as parties’ relative abilities to exert influence over each other in a particular situation. However, bargaining literature diverges on what exactly determines this relative ability. As a consequence, scholars often conflate structural factors, bargaining techniques and resulting policies meant to attract investment into an overall term that is hard to define or measure.¹¹

Responding to this inconsistency, I make an important distinction between bargaining power and deal quality. Bargaining power is based on economic and political factor endowments that stand out as relatively rare and are therefore less replaceable by exit options for the investor. In contrast, the outcome variable deal quality describes the resulting formal policies and informal agreements. Deal quality should, in theory be a reflection of countries’ relative bargaining power. Yet, this is not always the case due to the political economy around deal negotiations that comprises the core of this book’s analysis.

I define bargaining power as the relative structural attractiveness of a market to the investor. This attractiveness is purely based on countries’ economic factor endowments as well as political structural variables that are importantly not controllable by the state, relatively sticky over time and less replaceable by exit options on the investor side. This value will be higher when countries can offer larger stocks of productive labor, technology, infrastructure, natural resources, and large consumer markets as well as when they display politically favorable background conditions.

I assume that the stronger the bargaining power of the African government, the more likely that investors will want to sign a deal and be willing to carry costs,
including of domestic revenue and participation restrictions, if required by the government. As outlined in the introduction, that firms will be more willing to carry these costs in exchange for higher prospective returns is also reasonable given empirical examples from East Asia, and as described in the introduction, in particular from China itself.

As the roundtable discussion in the introduction of the chapter meant to demonstrate, the dominant academic discourse on foreign investment in Africa suggests that most African governments should have very limited bargaining power to exert influence over the conditions of deals with foreign investors. A brief historical overview shows that foreign investment in Africa is indeed a relatively recent phenomenon, has been largely driven by former colonial powers and remains scarce. Under colonialism, investments were primarily made to extract natural resources and labor from African colonies as well as to build and maintain local institutions that facilitate this export. A first global wave of foreign direct investment into colonies emerged at the start of the 20th century, slowed down during the First World War and continued thereafter with a focus on colonial trade (Buelens and Marysse 2006). After political independence, several African leaders – beginning in Kenya, Zimbabwe, Tanzania, Zambia, and Nigeria in the early 1960s – sought to become independent from the West through rapid industrial development following the advice of several dependency theorists to invest in local production of goods (Wallerstein 1974, Rodney 1972, Prebisch 1949, Singer 1949). But the suggested economic recipe of import substitution policies without a clear export strategy failed, and many countries were therefore left in even poorer conditions and dependence on the West (Bruton 1998). Most investment flows to Africa at the time originated from former colonial powers, the Soviet Union and China, and were politically motivated in order to keep alliances (to the US or the Soviet Union; and after the Sino-Soviet split also to the Non-Aligned Movement) during the Cold War.

As a response to the oil and debt crises, multiple economic depressions, and stagflation in the 1970s in several developing economies across the world, the World Bank and the International Monetary Fund (IMF) intervened to implement structural adjustment programs, which included stabilization (e.g. balance of payment and budget deficit reductions) and long-term adjustment policies (e.g. liberalization and privatization). Countries were required to implement these policies in order to obtain new loans or to lower interest rates on existing ones. As part of the trend of economic liberalization across national economies in the 1980s, development countries also gradually removed restrictions on inward foreign FDI such as screening or performance requirements, ownership restrictions and licensing agreements featuring technology transfer (UNCTAD 2000). Yet, these measures did still not lead to a significant increase in Western investment in Africa.

At the turn of the millennium, Sachs (2004) famously called for a shift from private to public investment and aid because the African region was still not competitive enough to attract significant amounts of private capital or from various sources. This was because several African economies were caught in a “poverty trap” (consisting of capital traps, saving traps and demographic traps) that has led to an equilibrium of both weak institutions and weak economic growth. Several
scholars later criticized Sachs’ call for aid and argued that there had been weak evidence for a positive causal relation between aid and development, and that negative effects of aid for governance and dependence overall outweighed its benefits (Deaton 2013, Moyo 2009, Easterly 2006). It remains the case, however, that compared to other developing regions, Africa has received the least amount of foreign investment inflows since the 1990s.

In the early 2010s, a new wave of economic thought, “experimental economics” (most famously Banerjee and Duflo 2011), emerged as a response to the aid versus investment debate between Jeffrey Sachs and William Easterly. Rather than tackle poverty with grand, national, one-size-fits-all policies, randomized impact evaluation should help us to better identify economic and political obstacles at the micro-level and create situation-specific policy solutions to slowly reduce poverty and kickstart growth. But even then, the assumption has generally been that there are endemic issues that need to be overcome first in order to become more attractive to foreign capital, and to set countries on a path of longer-term development.

Overall, all theories highlight high entry barriers to foreign investors and lead to two outcomes that disadvantage the African side. First, many countries in the African region still face a lack of significant foreign investment flows pouring in from various sources. As a result, there is often no or little competition on the investor side, which overall raises the cost of being selective as governments. Second, African economies compete in an environment with plenty of countries that offer similar “added values”; investors’ costs of replacing one country with another one that offers a better deal are consequently low. Overall, these two factors describe what I call here the Weak Bargaining Power Narrative – they force governments to act as deal takers and lead to a race to the bottom, with countries with the most open economies having the best chances of attracting foreign investors. In other words, when the ability to offer unique goods, fiscal incentives, or political stability to attract FDI to host countries is limited, but when investors are already hesitant to enter, the only way of luring them is then the removal of demands and policy restrictions.

Given that political leaders have limited bargaining power to impose restrictions on foreign investors, why would some countries, especially poorer ones like Ethiopia or smaller ones like Tanzania, still choose to impose stricter regulations at the cost of becoming even more unattractive to foreign investors as illustrated in Figure 1.1? Some governments might simply not view FDI as an important source of growth, prioritize nationalist policies, overestimate their bargaining power, or need to be accountable to domestic interest groups. The global spread of capitalism starting in the late 1980s has led to heightened awareness among governments that foreign investment is essential for achieving positive development outcomes. Yet, as Rodrik (2006) writes, “the policies spawned by the Washington Consensus have not produced the desired results” (p. 973) across developing countries. As a result, some governments might still be suspicious of the benefits of FDI. Relatedly, countries may prioritize nationalist policies over externally imposed advice or overestimate their own bargaining power. For example, against the advice of the Western organizations and businesses, Robert Mugabe passed an
Indigenization and Economic Empowerment law in 2007, coming into effect in 2008, which transferred 51 percent control of all firms to black Zimbabweans. Only in 2019, the finance minister Mthuli Ncube announced that the law would be lifted under mounting pressure from the crashing economy to attract more foreign investment.

In addition, political accountability may matter. Governments may face a trade-off between attracting foreign investment and ensuring that locals benefit from the new capital because they want to be re-elected. Some African governments have certainly used IMF conditions “to push through their preferred policies, which otherwise would not be approved”, thereby essentially using the IMF as a “scapegoat” (Vreeland 1999, p. 1). At the same time, for example South Africa with significant structural inequality inherited from apartheid may still face domestic political pressure to keep their B-BBEE policies privileging black individuals in the labor market although it may hurt the country’s attractiveness to investors. This suggests that rather than following the advice of the World Bank to liberalize and privatize in order to become more competitive, some countries may still choose for political reasons to engage in non-cooperative bargaining relationships with foreign investors over entry (following the models proposed by Grosse 1996, Grosse and Behrman 1992, Kobrin 1987, Vernon 1977, 1971).

The Weak Bargaining Power Narrative hinges on a few assumptions about investors, type of growth models, and the benefits and costs that are associated with entering and operating in developing markets but that may not hold anymore for all investors on the African continent today. The first assumption that the Weak Bargaining Power Narrative makes is that foreign investors are homogeneous in their preferences, specifically in the types of markets they are looking to enter, and that African countries have such low bargaining power that if they imposed any restrictions on foreign investors, the costs to investors would always outweigh the benefits. But with the emergence of South-South cooperation, an increasing number of investors originate from environments that have very different economic and political realities to the West. How does this affect their motivations, preferences and cost-benefit rationale when seeking to invest abroad? Put differently, and as Figure 1.1 suggests, what if for a subset of investors, the benefits actually outweigh the costs in more African countries than previously assumed?

Relatedly, the second assumption is that foreign investors are hesitant to enter African economies because their stocks of human capital and technology are low and cannot be accumulated short-term (as assumed by exogenous growth models). Yet, as outlined earlier, developing countries have an advantage of “catch-up growth” (Gerschenkron 1962). As a result, it is not clear that we always deal with investors who choose a narrative of “We are going to invest in country X although there is nothing there” or rather follow a strategy of “We are going to enter country X because there is nothing there (yet)” in the hope of large future returns. Perhaps the most famous example that the Weak Bargaining Power Narrative has failed to explain is the rise of China itself, where – as mentioned in the introduction – foreign investors poured in starting in the 1980s despite low stocks of human capital and technology, and significant policy barriers to entry.