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Foreign Direct Investment in Sudan: The Measures to Increase Inflows and Getting Full Benefits

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In a nutshell

- *Sudan is one of the developing countries that is endowed with abundant resources. However, these resources, i.e. arable land, water, cheap labour, and favourable climatic conditions, cannot work in isolation from other essential factors of production, on the top of them being an adequate amount of capital. This is because the country's domestic savings are far less than necessary to cover the capital needed to put the economy on the track of sustainable economic growth and development.*
- *The heavy reliance on low-productivity agriculture, the failure to channel domestic savings into domestic financial institutions, in addition to the customs that encourage luxurious consumption among the middle class, have greatly contributed to the widening of the gap between capital needed to initiate a real development process and the savings which are mobilized from domestic sources.*
- *Therefore, in the light of the unfeasibility of other external sources of capital, such as borrowing, aid and portfolio investments, the only accessible channel to fill capital's gap in Sudan can be achieved by hosting larger amounts of FDI (Foreign Direct Investment). However, the question arises to what extent Sudan can attract this FDI? In other words, what are the key factors in determining the ability of the country to be a favourable destination for FDI?*
- *The flow of foreign capital in the form of FDI is not an end itself. It is a means to provide the country's economy with an adequate volume of capital that helps in accelerating the process of economic growth, elevating exports, promoting imports, as well as facilitating the reduction of the high unemployment rates.*

- ***Introductory Remarks***

Like its counterparts from other developing countries, Sudan is considered extremely undercapitalized. Specifically, since its independence, the country has experienced a permanent situation of low domestic savings, fragmented economic structures, an unskilled labour force, and chronic political instability. These impediments have worked collectively in making the country confined in the trap of poverty and underdevelopment. However, the shortage in the provision of capital represents one of the strongest factors in deepening the country' economic problems. Therefore, the question that may be raised here is: How to provide Sudan’s economy with sufficient capital in order to achieve the desired economic goals?

Under the current domestic and international circumstances, the most appropriate source for capital and, thus, realizing a reasonable level of economic development in the country, can be attained by bringing in capital from abroad. However, bringing in foreign capital is not an easy mission since not all types of capital flows have the same contribution in boosting economic and social betterments in hosting countries. For instance, the provision of capital by borrowing from foreign countries and international financial institutions is considered unfeasible for Sudan since the country has been classified among the group of highly indebted developing countries (HIPC). Moreover, since debt servicing is not linked to the performance of the underlying investments, borrowing from abroad remains the least desirable form of capital source. The portfolio investments are also considered inconvenient for the Sudanese case. So far, the country does not possess a well-developed financial market through which the portfolio investments can be channelled to domestic sectors.

Nevertheless, FDI as an external form of finance has been classified as a superior source of capital. It intends to execute long run real investments and, as an outcome, is rising the levels of economic development. Besides, FDI is preferable for a country like Sudan because it is not only less volatile but it is also expected to be accompanied by many other advantageous benefits.

- ***The presence of FDI in Sudan***

Given its potential role in achieving the Sudanese nation's economic and social betterment, a wide range of incentives and polices have been considered to attract FDI. In this context, since its independence in 1956, Sudan has launched a dozen of investment acts and incentives, particularly the acts of 1956, 1958, 1970, 1990, 2000, etc. These acts, which comprised great hospitable packages, such as tax holidays, subsidized public utility prices, market protection, were meant to stimulate foreign investors to establish businesses in the country. Yet, despite of all these concessions and incentives, FDI flows into the country remained very low and were highly fluctuating.

The inward movements of the FDI into the country have, to a large extent, reflected changes in economic policies in general and especially the FDI policies which were pursued. These policies included the import substitution policy introduced in the 1960s, the nationalization and confiscation policy imposed by the May's regime in 1970s, the open-door policy at the end of the 1970s and 1980s, the adoption of an economic reform policy at the beginning of the 1990s, and the policy of exploiting oil in commercial quantities at the end of 1990s. These developments on the polices front have greatly impacted on the FDI flows, and in most cases negative consequences occurred on the inward FDI movements. For instance, the volume of inward per capita FDI was only \$0.1, \$0.00, and \$0.039 (less than one US dollar) in the years 1970, 1971 and 1972, respectively. In some years this indicator showed even negative values (in the year 1979 it became -0.1369), indicating an increase in capital exports from the country. Lately at the beginning of the 2000s, the facts on the foreign investment inflows to Sudan show significant improvements. However, these flows fall short of the volume needed to begin a real economic transformation.

While FDI was increasing in other developing countries, the flows into Sudan remained moderately low. This is very disappointing from a policymakers' perspective, given that the concessions have been deployed to catch the attention of FDI. This reality raises important issues concerning the identification of the factors that have led to this modest performance in FDI. Accordingly, the question about FDI's desirable impacts on the Sudan economy becomes linked to the existing puzzle on the factors that govern the movement of FDI. In view of that, two key issues can be raised here: First, if it is assumed that FDI has a positive impact on the country's economy, what would cause FDI to flow into Sudan, i.e. what are the factors that may encourage foreign investors to set up businesses in the country? Second, given the FDI's presence, what is the actual impact that this FDI's presence may have on the Sudanese economy?

- ***The Determining Factors of FDI inflows into Sudan***

To increase its FDI inflows, Sudan needs to satisfy three categories of fitness requirements. These include market, social and environment fitness criteria. First, market fitness signals the existence of the factors that make the country's economy fit for marketability conditions as anticipated by foreign businesses. Second, the social fitness factors comprise a combination of social factors that work together in assisting the country to be more welcoming for FDI activities. Third, the risk-free environment fitness conditions are related to the factors resulting from the possibility of unpredictable changes in the business environment, and to the probability that these changes can unfavourably (favourably) influence FDI's operations. In this regard, the evidence proves that these fitness factors play a key role in deciding on FDI flows. Especially the importance of factors such as infrastructure, trade openness, and the adoption of effective privatization policies, in creating the environment that fits FDI operations, has been confirmed. In contrast, factors such as political and economic instability in addition to increases in the urban population are found to be exercising negative influence on the amounts of FDI received by Sudan. More importantly, the education appears to have a weak role in stimulating FDI (if skilled labour can be imported by the foreign investors). Thus, with the aim to maximize FDI flows into Sudan, the policymakers should work honestly to go well with the above-mentioned fitness requirements. This can be achieved by considering the following policy actions:

(a) Expanding the infrastructural development

To increase FDI inflows, the priority in development programmes and policies in Sudan should be directed to mobilize resources to raise and to enhance infrastructures, including the introduction of enhanced telecommunications, modern paved road networks, ports, and a strong and effective civil service.

(b) Reinforcing the privatization policy

Noting the importance of privatization policies in motivating FDI flows into Sudan, the policymakers need to reinforce these policies by extending privatization to incorporate more projects and sectors. This can be done by opening the sectors that traditionally are dominated by government activity, such as infrastructure and transportation, for foreign investors. Diminishing government's role in running such economic activities would lessen the tax burden on the private sector and, therefore, would allow for more expansion in both foreign and domestic businesses. Additionally, since FDI is expected to use advanced technologies in running businesses, giving way to foreign investors to operate part of the public utilities would raise the quality of goods and services produced and, therefore, would improve the population's standards of living.

(c) Raising the degrees of trade openness

Adopting sound policies to tighten Sudan's connections with the rest of the world in addition to raising the degree of trade openness would be considered vital in attracting foreign companies to execute businesses in Sudan.

(d) Preserving political and economic stability

Owing to the negative impact of political and economic instability on FDI, policymakers need to work on creating a stable business environment by eliminating risky factors. This can be accomplished by widening the steps towards transparent environment by establishing a democratic system with power sharing. Equally important, the preservation of macroeconomic stability by mitigating high inflation rates and avoiding contradictions in economic policies appear to be crucial in diminishing the level of uncertainty and, thus, securing FDI flows.

(e) Outweighing the advantages and disadvantages of resources' seeking FDI

Giving opportunities for foreign FDI to exploit and to extract Sudan's natural resources should be encouraged and motivated. Utilizing such resources would boost economic growth as well as it helps in defeating other economic problems such as poverty and high unemployment rates. However, the exhaustive exploitation of these resources may impose negative consequences on the country's capabilities to realize sustainable development. Therefore, in allocating incentives for resources-based FDIs, a careful selection criterion must be taken to avoid resources exhaustion which may mostly be done at the expense of coming generations. Also, the environmental conditions of exploitation need to be considered.

- ***FDI and economic performance in Sudan***

Attracting the greatest amounts of FDI into Sudan is not an end as such; rather it is a means to realize other national development goals. FDI is being sought by most, if not all, policymakers as a means to alleviate the country's economic problems because, (1) it may complement investments run by local investors; (2) it secures the flows of sophisticated technologies from countries which are likely to possess higher or advanced technologies compared to Sudan; (3) it assists in transferring management knowledge and modern business practices; (4) it offers the country access to foreign markets; and (5) it creates new employment opportunities for unemployed people. Specifically, FDI flows are anticipated to speed up economic growth rates, to augment and diversify the country's exports, to create substitutes for imports, to promote domestic investment, and to cut high unemployment rates. In this regard, the evidence shows that FDI's presence in Sudan coincides with great improvements in such economic indicators. To further these improvements and, therefore, to reap the highest levels of FDI benefits, policymakers should work on different fronts with appropriate policy measures, including:

(a) Reforming the existing educational system

The educational system in Sudan is considered unqualified enough to permit the expansion in domestic as well as in foreign investments. This has to do with the fact that the current system fails to supplement the existing labour force with the skills and the knowledge required to raise its participation in well-developed and more sophisticated economic activities. The existing system focuses only on developing the theoretical capabilities of the students rather than giving them the aspirations to apply the gained knowledge to real life facts. With these shortcomings, efforts should be devoted to reform this system to realize the nation's higher development goals. The proposed reform can be done by replacing the old system by a high-quality one that fits FDI operations and, concurrently, serves in optimizing its returns on the economy. Specifically, vocational training programmes, engineering and computer-based specializations, must be put at the top of the nation's educational priorities in the coming years.

(b) Balancing FDI's geographical distribution

Although the larger inflows of FDI are encouraged to increase economic growth in Sudan, the positive and negative effects of FDI’s geographical distribution in achieving balanced development in the country should be taken into consideration. First, the concentration of FDI’s operations in the capital city of Khartoum will result in an unequal distribution of the national income among the population which, in turn, can create serious political and economic problems. The current conflict in the Darfur region stands as a concrete evidence for problems that find their roots in the imbalanced regional development. Additionally, increases in the capital city's population would result in pressures on the existing poor infrastructure and, thus, would reduce FDI flows. Therefore, policymakers should focus on creating a balanced development across different regions. This can help in achieving two objectives: (1) attracting more FDI from abroad and, therefore, paving the way for rapid economic growth rates; and (2) realizing a large degree of distributive justice for the country's economic cake. Therefore, FDI flows with a potential to create a more balanced development by establishing businesses in peripheries, transplanting new agro-based industries, and generating more job opportunities for rural workers, should be a priority development focus in the long run.

(c) Encouraging labour-intensive FDI

In designing FDI's policies and regulations, the role of FDI in creating job opportunities should be taken into consideration. Especially FDI with tendencies to use labour more intensively than capital should be encouraged. Initiating such a policy action would diminish the unemployment rates since the production techniques adopted by labour-intensive FDI allow an absorbing of labour supply surpluses.

(d) Encouraging FDI projects that engage in producing import substitutes

With a goal of reducing imports to the country, there is an urgent need to encourage FDI that will produce locally substitutes for imported goods. A strictly selective policy must be put in action to identify foreign investments that will enjoy the encouraging incentives. Specifically, the higher the contribution of a certain FDI project in producing goods that constitute a heavy burden on the balance of payments, the greater the incentives that should be granted to this project. Moreover, the larger the amount that will be deducted from the national economic surplus to import certain goods or services from abroad, the greater should be the encouragement that must be given to the FDI project that intends to produce those products. Moreover, the increases in the production of import substitution industries through FDI would provide local consumers with more goods and services and, thus, would contribute to raising the citizens' standards of living.

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