

3.11: Chapter Introduction

International Trade and Foreign Direct Investment

WHAT'S IN IT FOR ME?

1. What is international trade theory?
2. How do political and legal factors impact international trade?
3. What is foreign direct investment?

It's easy to think that trade is just about business interests in each country. But global trade is much more. There's a convergence and, at times, a conflict of the interests of the different stakeholders—from businesses to governments to local citizens. In recent years, advancements in technology, a renewed enthusiasm for entrepreneurship, and a global sentiment that favors free trade have further connected people, businesses, and markets—all flatteners that are helping expand global trade and investment. An essential part of international business is understanding the history of international trade and what motivates countries to encourage or discourage trade within their borders. In this chapter we'll look at the evolution of international trade theory to our modern time. We'll explore the political and legal factors impacting international trade. This chapter will provide an introduction to the concept and role of foreign direct investment, which can take many forms of incentives, regulations, and policies. Companies react to these business incentives and regulations as they evaluate with which countries to do business and in which to invest. Governments often encourage foreign investment in their own country or in another country by providing loans and incentives to businesses in their home country as well as businesses in the recipient country in order to pave the way for investment and trade in the country. The opening case study shows how and why China is investing in the continent of Africa.

Opening Case: China in Africa

Foreign companies have been doing business in Africa for centuries. Much of the trade history of past centuries has been colored by European colonial powers promoting and preserving their economic interests throughout the African continent. Martin Meredith, *The Fate of Africa* (New York: Public Affairs, 2005). After World War II and since independence for many African nations, the continent has not fared as well as other former colonial countries in Asia. Africa remains a continent plagued by a continued combination of factors, including competing colonial political and economic interests; poor and corrupt local leadership; war, famine, and disease; and a chronic shortage of resources, infrastructure, and political, economic, and social will. "Why Africa Is Poor: Ghana Beats Up on Its Biggest Foreign Investors," *Wall Street Journal*, February 18, 2010, accessed February 16, 2011, <http://online.wsj.com/article/SB10001424052748704804204575069511746613890.html>. And yet, through the bleak assessments, progress is emerging, led in large part by the successful emergence of a free and locally powerful South Africa. The continent generates a lot of interest on both the corporate and humanitarian levels, as well as from other countries. In particular in the past decade, Africa has caught the interest of the world's second largest economy, China. Andrew Rice, "Why Is Africa Still Poor?," *The Nation*, October 24, 2005, accessed December 20, 2010, www.thenation.com/article/why-africa-still-poor?page=0,1.

At home, over the past few decades, China has undergone its own miracle, managing to move hundreds of millions of its people out of poverty by combining state intervention with economic incentives to attract private investment. Today, China is involved in economic engagement, bringing its success story to the continent of Africa. As professor and author Deborah Brautigam notes, China's "current experiment in Africa mixes a hard-nosed but clear-eyed self-interest with the lessons of China's own successful development and of decades of its failed aid projects in Africa." Deborah Brautigam, "Africa's Eastern Promise: What the West Can Learn from Chinese Investment in Africa," *Foreign Affairs*, January 5, 2010, accessed December 20, 2010, www.foreignaffairs.com/articles/65916/deborah-brautigam/africa%E2%80%99s-eastern-promise.

According to CNN, "China has increasingly turned to resource-rich Africa as China's booming economy has demanded more and more oil and raw materials." "China: Trade with Africa on Track to New Record," *CNN*, October 15, 2010, accessed April 23, 2011, articles.cnn.com/2010-10-15/world/china.africa.trade_1_china-and-africa-link-trade-largest-trade-partner?_s=PM:WORLD. Trade between the African continent and China reached \$106.8 billion in 2008, and over the past decade, Chinese investments and the country's development aid to Africa have been increasing steadily. "China-Africa Trade up 45 percent in 2008 to \$107 Billion," *China Daily*, February 11, 2009, accessed April 23, 2011, http://www.chinadaily.com.cn/china/2009-02/11/content_7467460.htm. "Chinese activities in Africa are highly diverse, ranging from government to government relations and large state owned companies (SOE) investing in Africa financed by China's policy banks, to private entrepreneurs entering African countries at their own initiative to pursue commercial activities." Tracy Hon, Johanna Jansson, Garth Shelton, Liu Haifang, Christopher Burke, and Carine Kiala, *Evaluating China's FOCAC Commitments to Africa and Mapping the Way Ahead* (Stellenbosch, South Africa: Centre for

Chinese Studies, University of Stellenbosch, 2010), 1, accessed December 20, 2010, www.ccs.org.za/wp-content/uploads/2010/03/ENGLISH-Evaluating-Chinas-FOCAC-commitments-to-Africa-2010.pdf.

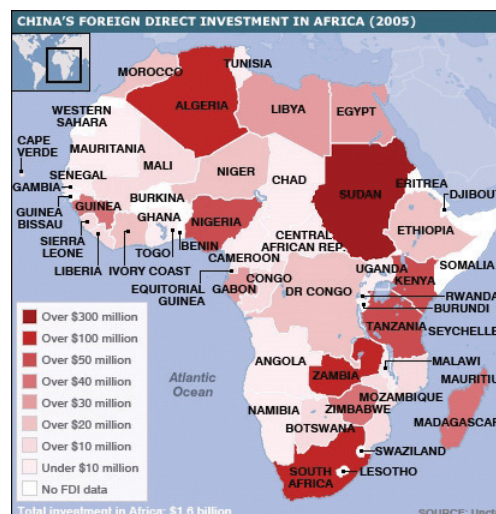
Since 2004, eager for access to resources, oil, diamonds, minerals, and commodities, China has entered into arrangements with resource-rich countries in Africa for a total of nearly \$14 billion in resource deals alone. In one example with Angola, China provided loans to the country secured by oil. With this investment, Angola hired Chinese companies to build much-needed roads, railways, hospitals, schools, and water systems. Similarly, China provided nearby Nigeria with oil-backed loans to finance projects that use gas to generate electricity. In the Republic of the Congo, Chinese teams are building a hydropower project funded by a Chinese government loan, which will be repaid in oil. In Ghana, a Chinese government loan will be repaid in cocoa beans. Deborah Brautigam, “Africa’s Eastern Promise: What the West Can Learn from Chinese Investment in Africa,” *Foreign Affairs*, January 5, 2010, accessed December 20, 2010, www.foreignaffairs.com/articles/65916/deborah-brautigam/africa%E2%80%99s-eastern-promise.

The Export-Import Bank of China (Ex-Im Bank of China) has funded and has provided these loans at market rates, rather than as foreign aid. While these loans certainly promote development, the risk for the local countries is that the Chinese bids to provide the work aren’t competitive. Furthermore, the benefit to local workers may be diminished as Chinese companies bring in some of their own workers, keeping local wages and working standards low.

In 2007, the UNCTAD (United Nations Conference on Trade and Development) Press Office noted the following:

Over the past few years, China has become one of Africa’s important partners for trade and economic cooperation. Trade (exports and imports) between Africa and China increased from US\$11 billion in 2000 to US\$56 billion in 2006....with Chinese companies present in 48 African countries, although Africa still accounts for only 3 percent of China’s outward FDI [foreign direct investment]. A few African countries have attracted the bulk of China’s FDI in Africa: Sudan is the largest recipient (and the 9th largest recipient of Chinese FDI worldwide), followed by Algeria (18th) and Zambia (19th). United Nations Conference on Trade and Development, “Asian Foreign Direct Investment in Africa: United Nations Report Points to a New Era of Cooperation among Developing Countries,” press release, March 27, 2007, accessed December 20, 2010, www.unctad.org/Templates/Webflyer.asp?docID=8172&intItemID=3971&lang=1.

Observers note that African governments can learn from the development history of China and many Asian countries, which now enjoy high economic growth and upgraded industrial activity. These Asian countries made strategic investments in education and infrastructure that were crucial not only for promoting economic development in general but also for attracting and benefiting from efficiency-seeking and export-oriented FDI. United Nations Conference on Trade and Development, “Foreign Direct Investment in Africa Remains Buoyant, Sustained by Interest in Natural Resources,” press release, September 29, 2005, accessed December 20, 2010, <http://news.bbc.co.uk/2/hi/africa/7086777.stm>.



Source: “China in Africa: Developing Ties,” BBC News, last updated November 26, 2007, accessed June 3, 2011, <http://news.bbc.co.uk/2/hi/africa/7086777.stm>.

Criticized by some and applauded by others, it’s clear that China’s investment is encouraging development in Africa. China is accused by some of ignoring human rights crises in the continent and doing business with repressive regimes. China’s success in

Africa is due in large part to the local political environment in each country, where either one or a small handful of leaders often control the power and decision making. While the countries often open bids to many foreign investors, Chinese firms are able to provide low-cost options thanks in large part to their government's project support. The ability to forge a government-level partnership has enabled Chinese businesses to have long-term investment perspectives in the region. China even hosted a summit in 2006 for African leaders, pledging to increase trade, investment, and aid over the coming decade. "Summit Shows China's Africa Clout," *BBC News*, November 6, 2006, accessed December 20, 2010, <http://news.bbc.co.uk/2/hi/business/6120500.stm>. The 2008 global recession has led China to be more selective in its African investments, looking for good deals as well as political stability in target countries. Nevertheless, whether to access the region's rich resources or develop local markets for Chinese goods and services, China intends to be a key foreign investor in Africa for the foreseeable future. "China in Africa: Developing Ties," *BBC News*, November 26, 2007, accessed December 20, 2010, <http://news.bbc.co.uk/2/hi/africa/7086777.stm>.

Opening Case Exercises

(AACSB: Ethical Reasoning, Multiculturalism, Reflective Thinking, Analytical Skills)

1. Describe China's strategy in Africa.
2. If you were the head of a Chinese business that was operating in Sudan, how would you address issues of business ethics and doing business with a repressive regime? Should businesses care about local government ethics and human rights policies?
3. If you were a foreign businessperson working for a global oil company that was eager to get favorable government approval to invest in a local oil refinery in an African country, how would you handle any demands for paybacks (i.e., bribes)?

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