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# FOREIGN DIRECT INVESTMENT AND GROWTH IN FRAGILE AND CONFLICT-AFFECTED COUNTRIES

## The Role of Peacekeeping and Natural Resources

By Lars Jensen

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# FOREIGN DIRECT INVESTMENT & GROWTH IN FRAGILE & CONFLICT-AFFECTED COUNTRIES

## The Role of Peacekeeping & Natural Resources

LARS JENSEN[1]


## Abstract

This study assesses the relationships between foreign direct investment (FDI), growth, natural resources, and UN peacekeeping operations (PKOs) in fragile and conflict-affected countries (FCAs). An unbalanced panel-dataset on conflict and peacekeeping covering 127 countries from 1989-2018 was created to estimate how FDI and growth are associated with periods of peace, conflict, and post-conflict, including the significance of having a PKO in the last. Main findings are:

- In 2018 all but two of the top 32 FCAs were either low income (LIC) or lower-middle income (LMIC) countries, and two-thirds could be categorized as resource dependent (RD). As a share of total LIC and LMIC, they accounted for 40% of countries, one-third of population, little more than 20% of GDP, and received about 20% of FDI.

- The group of countries that can be categorized as both FCA and RD receive the highest ratios of FDI-to-GDP averaging 5.6% per annum (2006-2018), whereas the group of non-RD FCAs has not attracted even 2%.

- Post-conflict periods without a PKO are not associated with recovery (higher than peacetime) rates of FDI nor economic growth, whereas periods coinciding with a PKO presence have higher FDI-to-GDP of close to 2 percentage points, and with so-called transformative PKOs a higher real GDP growth of more than 4 percentage points. Results also provide some tentative evidence that transformative PKOs and PKOs in resource-dependent economies are more effective in facilitating recovery rates of FDI and growth.

In conclusion, the study finds that fragility is not a major deterrent of resource-seeking FDI, largely explained by its set of unique investment determinants. Furthermore, that peacekeeping and natural resources are important overlooked factors in understanding the large country heterogeneity regarding the economic impact of conflicts and post-conflict economic recovery, and that peacekeeping could be an important measure in closing conflict-attributable GDP losses.


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## List of Figures, Tables & Boxes

## Acronyms

| | |
|---|---|
| BRD | Battle-Related Deaths |
| CPIA | Country Policy and Institutional Assessment |
| DFI | Development Finance Institution |
| EoDB | Ease of Doing Business Index |
| FCA | Fragile and Conflict-Affected |
| FDI | Foreign Direct Investment |
| FfP | Fund for Peace |
| FSI | Fragile States Index |
| GDP | Gross Domestic Product |
| GFCF | Gross Fixed Capital Formation |
| GPI | Global Peace Index |
| GPI_S | Security and Safety sub-index of the Global Peace Index |
| HIC | High Income Country |
| ICT | Information and Communications Technology |
| IEP | Institute for Economics and Peace |
| IMF | The International Monetary Fund |
| LDC | Least-Developed Countries |
| LIC | Low-Income Country |
| LMIC | Lower-Middle Income Country |
| MIGA | The Multilateral Investment Agency |
| MONUC | UN Mission in the Democratic Republic of the Congo |
| ODA | Official Development Assistance |
| PKO | Peacekeeping Operation |
| PPI | Positive Peace Index |
| RD | Resource dependent |
| SDG | Sustainable Development Goal |
| SIDS | Small Island Developing State |
| SSA | Sub-Saharan Africa |
| UCDP | Uppsala Conflict Data Program |
| UMIC | Upper-Middle Income Country |
| UN | United Nations |
| UNCTAD | UN Conference on Trade and Development |
| UNMIL | UN Mission in Liberia |
| UNOMIL | UN Observer Mission in Liberia |
| WB | The World Bank |

# Introduction

Post-conflict countries are often left with the destruction of essential infrastructure, disrupted public services, and increased levels of unemployment and poverty, all of which contribute to an elevated level of fragility and higher risk of conflict relapse. Domestic capital markets are weakened and so is the ability of government to raise revenue. Foreign investors and donors can help fill funding gaps thereby restoring infrastructure and services, provide foreign exchange and generate jobs and income — at least in theory. Investors' risk perception of post-conflict countries works against the need to attract funding as one of the best predictors of conflict onset (relapse) is a (not-too-distant) history of conflict. Donors, Development Finance Institutions (DFIs) and the international community work in different ways to help countries recover and avoid a return to conflict for instance by increasing official development assistance (ODA) or by the provision of tailored financial instruments that help rebalance the risk-reward profile facing private investors.[2] Another important instrument is peacekeeping - that is, the deployment of a peacekeeping operation (PKO). Whereas the literature has mostly found that PKOs are effective in terms of reducing and preventing conflict, it is not well-understood to what extent PKOs contribute to investments and overall economic performance — key ingredients to sustaining peace.

Before the paper examines this question empirically in section 3, section 1 starts by discussing the possible links between peacekeeping, FDI and fragility, including by looking at the example of Liberia. Section 2 then takes a closer look at the size and nature of FDI flows going to FCAs relative to non-FCAs, including the importance of considering natural resource wealth, and includes three country examples; Angola, Mozambique, and Yemen. Finally, section 4 concludes the paper.

For developing countries, FDI is often viewed as a particularly important source of finance as it can help fund infrastructure, create jobs, and raise economic productivity.[3] But not all FDI is considered equally conducive to sustainable development and while public data on sectoral FDI is limited, it is commonly understood that a high share of the little FDI going to lower income developing countries is invested in the extractives sector. Although natural resources provide countries with great development opportunities, the so-called "resource curse" literature has pointed out that, if not carefully managed, natural resource wealth can be detrimental to sustainable development through a multitude of social, economic, environmental, and governance channels.[4]

Relative to other types of FDI often termed market-seeking, resource-seeking FDI is less likely to lead to any significant transfer of technology, skills or knowledge, and it is known to create fewer jobs per dollar invested. The extractives industry is capital-intensive and, in developing economies, most of the necessary machinery and equipment is imported. Extraction tends to rely little on host-country production inputs. Extracted materials are exported to the global market at global market prices and settled in US dollars. However, resource-FDI can help generate significant rents accruing to governments, which could be used

[2] One example is the World Bank's Multilateral Investment Guarantee Agency (MIGA), which directly offers foreign investors insurance products some of which are tailored to FCA countries, e.g., MIGA's product against war, terrorism and civil disturbance. The purpose is to offer a risk insurance product that would otherwise not have been provided by the market and thereby attract private investors to help fund recovery and development.
[3] The Sustainable Development Goals (target 10.b) explicitly mentions the need for Least Developed Countries (LDCs), African countries and Small Island Developing States (SIDS) to attract more FDI in accordance with national plans and priorities. Some of the benefits of FDI are that it can help compensate for underdeveloped domestic financial markets; it often comes with a large physical capital component, which can help fill important infrastructure gaps, and it often comes with a transfer of both technology, skills, and knowledge that can raise economic productivity. Labor-intensive FDI is viewed as particularly conducive to developing countries with a large and fast-growing workforce (many in Africa), and especially so when it also generates links to local businesses either as off-takers or suppliers of goods and services.
[4] For a good overview of the different cause and effect explanations in the resource curse literature see NRGI (2015) and Badeep et al. (2017).

to fund health, education, social services, environmental protection, infrastructure, and so on. Because of the nature of the extractives sector, resource-FDI determinants are also highly different from market-FDI determinants which is key to understanding the dynamics of investment flows and growth in resource-dependent developing economies, including FCAs.

Whereas key market-seeking FDI determinants are the size, growth, and stability of the economy; the quality, quantity and price of domestic production inputs; access to ICT and other market infrastructure; and the functioning of market institutions, these factors matter less for resource-FDI. Main determinants of resource-seeking FDI are likely to be global commodity prices; the size and accessibility of resource deposits, and; in FCAs to what extent production facilities and infrastructure necessary for exports (pipes, roads, rails, and ports) are, or can be expected to be, shielded from any ongoing or future conflict. As an example, offshore facilities are likely to offer more protection against such risks.

Another key determinant is the financial attractiveness of the agreement the investor can negotiate with the government, especially in terms of taxes, royalties, and capital transfers, and importantly the likelihood that the government will stay committed. In other words, political risk. It has also been argued that for resource-seeking FDI in least developed countries (LDCs) there are good reasons to believe that investors often prefer to deal with autocratic regimes as they can grant more favorable terms and offer more governance and economic stability (Li, 2017). This might also explain why one study finds that higher levels of democracy do not help attract more FDI in countries that are resource dependent (Aseidu & Lien, 2011).[5]

## 1. UN Peacekeeping & FDI

It is unclear if and how foreign investors factor in a PKO presence as part of their investment decision. On one hand, having a PKO might be perceived as a signal of elevated risk. In fact, one of the criteria used by the World Bank to label a country as fragile is the presence of a PKO. More specifically, the presence of a PKO (during the last three years) puts a country on the World Bank's so-called 'Harmonized List of Fragile Situations,' regardless of the country's CPIA score — a score otherwise used to classify countries as fragile or not.[6]

On the other hand, it is possible that investors view a PKO as a positive market signal that risk is better