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A FRAMEWORK FOR ATTRACTING FOREIGN DIRECT INVESTMENT TO THE SOUTH AFRICAN DEVELOPMENT COMMUNITY

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A research proposal submitted to the faculty of Management, University of the Witwatersrand for the degree of Master of Management (in the field of Public and Development Management)

October 2008

Abstract

"Today, Africa is spoken of only in pessimistic terms. The sum of its misfortunes – its wars, its despotisms, its corruption, and its droughts – is truly daunting." (Martin Meredith, 2005).

The African continent is rich in resources, culture and history, but yet it is the poorest economically. "Whilst making up more than 25 per cent of the inflow to the developing world in 1970, Africa's figure for 1997 was less than 5 percent" (World Bank, 2001). There is theoretical and empirical proof that the impact of FDI on host country economic growth is manifold. FDI is integral for stimulating sustained growth in developing countries. Alarmingly, a poor region like Africa that so desperately needs to increase its growth rate, has not managed to attract FDI despite major attempts at enticing FDI.

This research proposal contextually reviews the literature on the importance of increased global FDI, as well as the literature on the positive correlation between FDI and economic growth. This study however, focuses primarily on the factors that attract FDI, and what SADC countries can do to increase their share of global FDI.

Declaration

I declare that this report is my own, unaided work. It is submitted in partial fulfilment of the requirements of the degree of Master of Management (in the field of Public and Development Management) at the University of the Witwatersrand, Johannesburg. It has not been submitted for any degree or examination to any other university before.

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Miles Kubheka
30 October 2008

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CHAPTER 1

PROBLEM STATEMENT AND METHOD OF INVESTIGATION

INTRODUCTION

"Africa is spoken of only in pessimistic terms. The sum of its misfortunes – its wars, its despotisms, its corruption, and its droughts – it is truly daunting. No other area of the world arouses such a sense of foreboding. Most African countries are effectively bankrupt, prone to civil strife, subject to dictatorial rule, weighed down by debt and heavily dependent on Western assistance for survival" (Meredith, 2005).

Ironically, Africa whilst poor economically, is a continent rich in resources, culture and history. What is very paradoxical, is that a continent that is so rich in natural resources, has attracted the least foreign direct investment (FDI). Whereas newly industrialised economies such as China and India with no mentionable natural resources have attracted double digit growth in FDI. UNCTAD (2000) defines FDI as an "investment involving a long-term relationship in an enterprise resident in an economy other than that of the foreign investor."

Africa's inability to attract FDI is even more reason for concern when one considers that FDI has actually been increasing to developing countries. In fact, the World Bank (2001) declared that "Foreign Direct Investment to developing countries has increased from $24 billion (24% of total foreign investment) in 1990 to $178 billion (61% of total foreign investment) in 2000. While making up more than 25 percent of the inflow to the developing world in 1970, Africa's figure for 1997 was less than 5 percent (ibid.)". This is alarming when one considers that a poor region

like Africa, which so desperately needs FDI in order to decrease the number of people living in abject poverty, has not managed to attract FDI.

African policy makers have long realised the manifold impact of FDI. In this realisation, the policy makers have in the last three decades practised responsible macroeconomic policies. However, despite the responsible macroeconomic practices and global FDI flows having risen steadily to the record levels of $1.411 trillion reached in 2000, it is distressing that Africa has managed to attract only 2.7% of global FDI (UNCTAD, 2006).

As defined in the problem statement, this paper is an exploratory study that examines how developing countries such as those in the South African Development Community (SADC) can be more successful at attracting at attracting Foreign Direct investment.

1.1 PROBLEM STATEMENT

The problem statement defines the core focus of this research document. This research paper seeks to understand what the SADC countries need to do to attract more substantial Foreign Direct investment. The SADC region consist of the following countries; Angola, Botswana, DRC, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe.

The World Bank (cited in UNCTAD 2005, p. 1) stated that;

> "following independence, SADC policy makers across the region hoped that attracting FDI would provide the catalyst for a "late industrialisation" drive. … the architects of structural adjustment also saw increased FDI as key to sustained economic recovery, this time in conformity with "market fundamentals". From this perspective, the pursuit of responsible macroeconomic policies

> combined with an accelerating pace of liberalisation, deregulation and, above all, privatisation were expected to attract FDI to Africa."

However, despite the responsible macroeconomic policies and increased global FDI flows Africa has only managed to attract only a paltry 2.7% of global FDI (UNCTAD, 2006). The problem statement is therefore that the SADC countries need to find a successful systematic approach to increasing the share of global FDI. This is particularly important if the SADC countries are to achieve the required economic growth necessary to meet the Millennium Development Goals.

1.2 RELEVANCE OF THE STUDY

This study is relevant because one of the main themes of the Millennium Development Goals (MDG) is poverty reduction. The United Nations General Assembly in September 2000, embarked to reduce the number of people living on less than a dollar a day by 50% by the year 2015 (Dikhanov, 2005). Achieving this Millennium Development Goal is therefore particularly important for Africa, as the continent's poverty statistic is tremendously high. Dikhanov, (2005) states that Africa as a region houses some of the poorest countries in the world. Approximately 48% of Africa's population live on less than one dollar a day.

In contrast to other developing countries which have been improving their poverty conditions, Africa has regressed. In the 1970s for example, Asia had the highest rate of poverty in the world and Africa had a low rate of 11%. By the year 2000 things had changed as Asia's poverty rates were on the decline and Africa's were on the rise. In the year 2000, 420 million Africans out of 630 million (66%) lived on less than $1 a day (Dikhanov, 2005).

Dikhanov (2005) goes on to predict that the global goal of halving the world poverty will be achieved by 2015, largely due to Asia's successes. Africa on the other hand will then account for two thirds of the world's poverty. It is evident that if Africa does not do something drastic to improve its current situation, it will be burdened with 60% of the world's poor in the next seven years.

According to the Report of the commission for Africa (2005), if Africa is to reach its Millennium Development Goal of halving the number of people living on less than US$1 a day by 2015, it must achieve an aggressive economic growth rate of at least 7% per annum. For Africa to reach this aggressive growth rate, it needs to create and develop a domestic climate for investment. Effectively, Africa needs to increase its share of the global Foreign Direct Investment in order to meet its MDG goals. It is therefore important to investigate how Africa can increase its share of global FDI.

1.3 METHOD OF INVESTIGATION

The investigation of Foreign Direct Investment is not a new one, and thus there are immense volumes of both data and research on the subject matter. However, finding data and research specifically focusing on Africa (particularly SADC) has been challenging. It has even been more challenging to find comprehensive and current surveys. The most recent comprehensive survey was conducted in the year 2000. Whilst this survey is dated, its data is used primarily to show the correlation between good policy, business facilitation, host country specific resources and FDI.

The World Business Environment (WBE) Survey was conducted by the World Bank in 1999/2000. It covered about 10,000 firms in 80 countries.

The sample for Sub Sahara Africa included 413 foreign firms in 16 countries. Regrettably, only seven of the 16 countries were SADC member countries. This included Botswana, South Africa, Namibia, Tanzania, Malawi, Zambia and Zimbabwe. The sample Respondents were asked to judge on a four point scale the extent to which a particular factor constrained their business operations in a country (1= no constraint to 4= severe constraint).

The method of investigation chosen is therefore both quantitative and qualitative, and is based on a diverse spectrum of literature spanning from journals, surveys, periodicals, internet, newspapers, as well as industry research. For comparison purposes; data and research surveys from the same period in time was used.

As much as comprehensive research surveys on the determinants of FDI in Sub Sahara Africa are scant; the literature on FDI itself is large. It is therefore important to indicate the scope of this paper. Although the linkage between growth and FDI is discussed in this paper, it is not the main focus. Growth is discussed primarily to show that there is a positive linkage between increased FDI flows to developing countries and positive growth in the host countries. Additionally, the paper also delves into the determinants of FDI, aiming not to debate the merits of these determinants, but rather to show a positive correlation between they being present in the host country, and the increased attraction of FDI to that host country. The research questions and topics to be covered in this thesis are highlighted below.

1.4 RESEARCH QUESTIONS

The following three questions will frame the research:

- What is the importance of FDI to the economic growth of the SADC region?
- Which investment determinants play a role in attracting FDI in developing countries?
- Is there a framework that the SADC region can apply in order to attract a greater share of the global FDI?

These research questions set the tone for what has to be covered in the following chapters.

1.5 CHAPTER OUTLINE

This thesis consists of five chapters. Chapter 2 reviews the relevant literature with regard to the definition of Foreign Direct Investment, linkages of FDI with growth, and the importance of FDI in the context of the SADC countries.

Chapter 3 looks at defining FDI determinants as well building a theoretical framework for attracting FDI to developing countries.

Chapter 4 applies the FDI framework developed in chapter 3 to SADC host countries. This chapter uses primary research that was conducted by the World Bank in 1999/2000. It judges on a four point scale the extent to which a particular factor constrained their particular business operations in a country.

Chapter 5 concludes by looking at tangible policy solutions that the SADC countries, can explore in order to attract substantially more significant FDI inflows.

CHAPTER 2

A LITERATURE OVERVIEW OF FDI

2.1 INTRODUCTION

According to the current economic projections, it is evident that Africa will not meet its MDG goal of halving the number of people living on less than $1 a day. In fact, it is likely that in Africa the number of people living on less than $1 a day will double. The lack of financial resources has long prompted African leaders into looking for means to attract foreign direct investment (FDI). Prasad et al. (2003) concur that in "the last two decades FDI has assumed a prominent place in the strategies of economic renewal being advocated by policy makers at the national, regional and international levels."

The prominence of FDI strategies has led to Prasad et al. (2003) noting the experience of a small number of fast-growing East Asian newly industrialised economies (NIEs) like China. China as well as India have both become a case study of the success that awaits developing countries should they be able to attract FDI. China has shown that attracting FDI can help low-income countries avoid a further build-up of debt and thus directly tackle the causes of poverty. China's success has resulted in developing countries attracting FDI on the assumption that it will bring stable capital inflows. Moreover, developing countries believe that FDI will also bring with it greater technological know-how, higher-paying jobs, entrepreneurial and workplace skills, and new export opportunities.

The FDI Confidence Index (2006) suggests that the main reason why Asian developing countries like China and India currently dominate the global FDI flows, is their pursuit of responsible macroeconomic policies combined with an accelerating pace of liberalisation, deregulation, and

above all, privatisation. China and India enjoy the most positive investor outlook and are likely first time investment opportunities, and most preferred offshore investment locations for business processing and IT services.

Table 2.1 illustrates that the Asian developing countries have experienced the highest increase in FDI in the last two decades as compared to other developing countries. Subsequently, Asia has also seen the highest income growth in the last two decades and therefore low poverty rates (United Nations, 2002)

Table 2.1

Distribution of FDI flows throughout the world, 1980-2001

	Inward FDI (%)	
	1980	*2001*
Developed countries	**84.3**	**68.4**
Western Europe	39	45.7
North America	41	20.7
Other developed countries	4.3	2
Developing countries	**15.6**	**27.9**
Africa	1	2.3
Sub-Saharan Africa	0.4	1.6
Latin America and the Caribbean	13.6	11.6
Asia-Pacific	0.9	13.9
South, East and South- East Asia	6.5	12.8
Central and Eastern Europe	**0.1**	**3.7**

Source: UNCTAD World Investment Report 2002 and UNCTAD FDI/TNC database: http://stats.unctad.org/fdi/

The above table suggests that whilst East and Southeast Asia rake in an astonishing 12.8% of the global FDI flow, Africa on the other hand continues to register a dismal 2.3% and sub-Sahara Africa 1.6% (UNCTAD, 2002)- indeed a disturbing picture. As discussed, the Asian newly industrialised developing countries like China and India therefore make a positive case for FDI and growth. It is therefore important also to investigate which macroeconomic policies attract FDI. This paper aims to take learning from other developing countries and propose a macro-socio–economic model that will facilitate alleviating Africa's dire situation. This is vitally important if the region is to reach its target of a 7% growth rate.

Since 1960 Asia, the largest and most populous of the continents has become richer faster than any other region of the world. The eastern part of Asia turned in a superior performance. The "Four Tigers"; Hong Kong, Korea, Singapore, and Taiwan Province of China had annual growth rates of output per person well in excess of 6 percent over a 30-year period. The impact on poverty alleviation is such that an average citizen of a non-Asian country in 1990 was 72 percent richer than his parents were in 1960, the corresponding figure for the average Korean is an astonishing 638 percent. (Sarel, 1996)

There are two key lessons that can be taken from newly-industrialised developing countries such China and India. Firstly, Africa needs to increase its share of the global Foreign Direct Investment. Secondly, African policy makers must give substantially more attention to the crucial link between investment and socio-economic progress.

Hoeffler's study (cited in Devarajan, et al 2002, p. 2) concurs;

> "Africa's dismal growth performance post-independence period was significantly due to lower investment as compared to other regions during the same period. During the years 1960-94 Africa invested 9.6% of GDP (measured at international prices), whilst the ratio of other developing countries was 15.6%."

In other words, not only did Africa attract the least FDI but it also invested the least in its development. This has thus resulted in Africa having a poor socioeconomic performance. China has shown that attracting FDI can help low-income countries avoid a further debt build-up whilst directly investing in its development. Most developing countries, including Africa, now see FDI as a panacea to achieving their target growth rates. The rise in prominence of FDI has been accompanied by an increase in competition amongst the developing countries to attract it. This has resulted in the host governments lifting restrictions on operations of foreign firms in their countries.

It is now apparent as to why developing countries need FDI. It is also important to understand the rationale for FDI by firms in a global market economy. The World Investment Report (2006) suggests that the basic rationale for FDI by firms in a global market economy, is to increase or protect their profitability and/or capital value. One of the ways in which TNCs are achieving this goal, is by engaging in FDI. This is done either to better exploit their existing competitive advantages, or to safeguard, increase or add to these advantages. Economic and political drivers that trigger the internationalisation of TNCs (or result in their further overseas expansion) can be wide ranging. They often include a small home market (relative to a company's operations or ambitions), competitive pressures (which are intensifying in an increasingly liberalising world) and government policies aimed at encouraging foreign expansion. These

drivers are likely to vary, having different impacts on companies, depending, for example, on their competitive situation, motives and choices.

What can be concluded from this introduction is that total global FDI has increased drastically. Moreover FDI to developing countries has almost doubled in the last two decades. Asian newly industrialised developing countries that pursue responsible macroeconomic policies combined with liberalisation, deregulation and, privatisation have dominated the attraction of FDI. This has resulted in FDI taking a prominent position in the strategies of economic renewal being advocated by policy makers. It is therefore important for African countries to understand FDI, and why TNCs invest where they do. In order to understand FDI, it must first be defined.

2.2 DEFINING FOREIGN DIRECT INVESTMENT (FDI)

The definition of foreign direct investment, and therefore its measurement, has changed considerably over time. Definitions and measurements still differ among countries, despite the efforts of international agencies to push for uniformity.

Dahl (2002, p. 4), in summarising UNCTAD's definition of FDI , emphasised that in order not to confuse Foreign Direct Investment (FDI) with other kinds of investments that cross national borders, FDI must be defined as follows;

> "… an investment involving a long-term relationship and reflecting a lasting interest and control of a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor (FDI enterprise or affiliate enterprise or foreign affiliate)".

This definition is reported in international statistics and cited widely. In the international reporting of statistics, FDI is regarded by the UNCTAD (2000) as an investment that has the following three characteristics:

- Equity capital is the foreign direct investor's purchase of shares of an enterprise in a country other than its own.
- Reinvested earnings are the investor's shares of earnings not distributed as dividends by affiliates or earnings not remitted to the direct investor.
- Retained profits by affiliates that are reinvested in a form of intra-company loans or intra-company debt transactions; i.e. short- or long-term borrowing and lending of funds between direct investors (parent enterprises) and affiliate enterprises.

The equity forms of investment, as referred to above, are in the UNCTAD methodology distinguished from non-equity forms of investments. The non-equity forms of investments are for instance subcontracting, management contracts, turnkey arrangements, franchising, licensing and product sharing.

It is clear from the above definition that the best kind of FDI is the kind that doesn't board a ship to another developing market when the going gets tough. Non-equity type investments tend to be short term and footloose, and this makes them unpractical for a region like sub-Sahara Africa that needs consistent FDI for grow and to catch up with the rest of the world. Now that there is a common and globally accepted definition of FDI, it is critical to understand how FDI is distributed globally.

2.3 AFRICA'S LIMITED SUCCESS TO ATTRACT GLOBAL FDI

In the introduction to this chapter, the inequitable distribution of global FDI was discussed. The focus was to distinguish between developing countries that have successfully attracted FDI and the ones that have not. In order to holistically evaluate the importance of FDI, it is important to review literature on demand and supply side. It is imperative to understand the rationale for capital movements and investments globally.

Trans National Corporations (TNCs) such as Microsoft, McDonald's, Mercedes-Benz, Starbucks, Nike, etc; have become very important in the global economy. One can go as far as to say that TNCs are indicative of how governments trade.

UNCTAD (cited in Dahl, 2002, p. 4) agrees;

> "the largest 100 TNCs have an overwhelming influence on where the world's foreign direct investment is invested. In 1999 all except one of the largest 100 TNCs were located within the developed world, i.e. in Europe, North America or Japan. The assets of these TNCs were $2 trillion and accounted for about one-eighth of the total assets of all foreign affiliates worldwide in 1999, and these corporations can claim to be among the most important stakeholders and drivers of our contemporary international production."

Table 2.2 illustrates the above point. In 1999, the developed countries attracted three-quarters, or US$636 billion of the total inflow of FDI from TNCs. Dikhanov, (2005) also demonstrated in his work that the richest 20% of the world's population control approximately 80 of the world's wealth.

Table 2. Inflow of FDI to Africa and groupings of countries in 1999.

	US$ Billion	Percent
Developed countries	**636**	**76**
Developing countries	**205**	**24**
Africa	*10*	*1.2*

Source: UNCTAD (2000:29)

UNCTAD (cited in Dahl, 2002, p. 4) continues to note that "Africa has during the last three decades managed to attract more FDI in absolute terms, from around 8 dollars to almost 15 dollars per $1,000 of GDP between 1970-1997." However, in absolute terms of the total inflow of FDI to the developing world, Africa has slowly been losing ground. While making up more than 25 per cent of the inflow to the developing world in 1970, the figure for 1997 was less than 5 per cent."

This trend is alarming and should be thoroughly analyzed and scrutinised since FDI is indicated as an important substitute for domestic investments. If it holds true that FDI is both a catalyst and the driver for economic growth, then the identification of incentives for FDI can be seen as a highly significant exercise.

African policy makers have endeavoured to identify the incentives for FDI, but despite their efforts to comply with policy advices, the record for the past two decades with respect to attracting FDI and reducing poverty has been disappointing at best. Both the World Bank and the IMF (cited in UNCTAD 2005) concur that despite responsible macroeconomic policies, accelerated liberalisation, deregulation and privatisation Africa has failed to attract FDI.

In the attempt to forge consensus, as well as the understanding of African development failures, Collier and Patillo, (UNCTAD 2005) noted in their study, that Africa has high returns on FDI however low levels in FDI inflows. They interpreted this as symptomatic of past policy mistakes, and also suggestive of the potential rewards awaiting the region. This of course is assuming that Africa can improve its governance image in the eyes of international business.

Governance image alone is not sufficient to change the perception regarding Africa in the eyes of international business. Concerning this mattera report by the OECD (UNCTAD 2005, p.2) attributes Africa's spectacular failure to attract FDI to ''a mix of unsustainable national economic policies, poor-quality services, closed trade regimes, and problems of political legitimacy, thus advising governments to redesign their macroeconomic, trade and industrial policies to attract FDI".

As FDI brings with it the creation of employment, managerial skills, and technology, it is therefore crucial for the SADC region to improve its economic policies, poor-quality services, closed trade regimes, and political legitimacy. It is certain that SADC has to increase its share of global FDI for the region to achieve its development priorities. Ribeiro (2000) noted,

> "the development priorities of SADC countries to also include achieving sustained income growth for their economies. This was to be achieved by raising investment rates, strengthening technological capacities and skills, and improving the competitiveness of their exports in world markets; distributing the benefits of growth equitably by creating more and better employment opportunities."

Asiedu (2002) (cited in Ahmed, et al., 2005) demonstrates that there are a number of factors that explain Africa's minimal success in attracting FDI. Asiedu states that African countries have lost ground relative to

other regions because they are less open than other emerging markets. According to Asiedu, African countries are perceived as very risky; despite absolute improvements in the policy environment.

Similarly, Rogoff and Reinhart (cited in Ahmed, et al., 2005) argue that the volatility of the region, with regards to regional conflicts, unstable rates of inflation, and frequent currency crashes may explain why Africa lags behind other regions in attracting FDI. Comparing South Africa with a group of similarly rated countries, Arvanitis (Ahmed, et al., 2005) finds that South Africa's low growth rates can be attributed to the lack of skilled labour and repressive trade policies.

Based on some African success stories, Basu and Srinivasan (cited in Ahmed, et al., 2005) posit that political and macroeconomic stability, well-designed structural reforms, and natural resources can contribute to an increase in FDI in these countries.

African policy makers have heeded this call for structural and policy reforms. According to the World Investment Report (2006), a total of 205 global policy changes were identified by UNCTAD in 2005. Africa led the way in policy changes and accounted for 53 of the 205 policy changes. A close second and third was Asia and Oceania (48). The changes made conditions more favorable for foreign companies to enter and operate. The changes introduced included; sectoral and cross-sectoral liberalisation, promotional efforts, operational measures and FDI admission.

Despite their efforts to comply with policy advices, the record for attracting FDI to Africa has been reflected as dismal in studies by Haque, Nelson & Mathieson and Asiedu (Day, et al., n.d) indicate that Africa is rated as a riskier investment opportunity due to the bad reputation of the

continent. Africa's bad reputation has had an influence on the amount of FDI that flows into African countries. These findings show that Africa's bad reputation is a major factor separating Africa from other developing countries. Political risk is seen as a deterent of investment decisions with increasing importance to political stability. However, there are other contributing factors, such as; the slow development of domestic markets and the lack of macroeconomic growth.

A conclusion can be drawn that Africa is seen by global investors to have poor economic policies, poor-quality services, closed trade regimes, and political illegitimacy. Whether this is a perception or a reality the net result is that Africa has not fared well in the competition for global FDI. African countries also face stiff competition from other developing countries such as China, India and Brazil in attracting global FDI. The situation is further compounded by the fact investors also view Africa as high risk, because of its perceived mix of unsustainable economic policies and problems of political legitimacy. Some African policy makers argue that this is a perception, and that in reality it is a totally different matter. African policy makers claim this is Afro pessimism, basically bad neighbourhood syndrome. There is literature that suggests being situated in Africa is a key influence on the amount of FDI that flows into the country.

These are all major hurdles that Africa will need to overcome if it is to increase its share of global FDI. The introduction to this chapter suggested that there is *prima facie* evidence that increased FDI leads to economic growth.

2.4 THE IMPACT OF FDI ON ECONOMIC GROWTH

As mentioned above, developing countries need to achieve and maintain sustained income growth for their economies. The importance of economic growth to developing countries has directed a sharp focus on the critical role that foreign direct investment can play.

FDI can be shown to affect growth endogenously, as it generates increasing returns on production via externalities and productivity spillovers. Even at face value, it can be seen how the inflow of FDI physical capital has a potential for increasing the rate of economic growth in the host country.

Johnson (2005) noted that,

> "despite the straightforwardness of the argument, empirical evidence on a positive relationship between FDI inflows and host country economic growth has been elusive. When a relationship between FDI and economic growth is established empirically it tends to be conditional on host country characteristics such as the level of human capital, see for example de Mello (1999) and Borensztein et al (1998)."

The endogenous growth theory as opposed to neoclassical models of economic growth, provides a framework for studying the link between FDI and economic growth that makes it possible to take the characteristics of FDI into account, and confirms the theoretical relationship by empirical evidence.

As we have discussed, economic growth is important to developing countries such as the SADC countries. At face value, FDI is seen as a panacea to achieving economic growth. There is ample literature on the subject, and many divergent views on whether or not FDI leads to

economic growth. These divergent views have been critically analysed and summarised as follows in Johnson (2005, p.3);

> "Balasubramanyam et al (1996) found that FDI has a positive effect on economic growth in host countries using an export promoting strategy but not in countries using an import substitution strategy. Another study based on developing economies is Borensztein et al (1998) examined the role of FDI in the process of technology diffusion and economic growth. The Borensztein paper concludes that FDI has a positive effect on economic growth but that the magnitude of the effect depends on the amount of human capital available in the host country. Olofsdotter (1998) provides a similar analysis. Olofsdotter finds that an increase in the stock of FDI is positively related to growth and that the effect is stronger for host countries with a higher level of institutional capability as measured by the degree of property rights protection and bureaucratic efficiency in the host country.
>
> In contrast to the preceding studies, De Mello (1999) only finds weak indications of a positive relationship between FDI and economic growth despite using both time series and panel data fixed effects estimations for a sample of 32 developed and developing countries.
>
> Zhang (2001) and Choe (2003) analyses of the causality between FDI and economic growth found that in five cases, economic growth is enhanced by FDI but that host country conditions such as trade regime and macroeconomic stability are important. According to the findings of Choe (2003), causality between economic growth and FDI runs in either direction but with a tendency towards growth causing FDI; there is little evidence that FDI causes host country growth.
>
> Carkovic and Levine (2002) conclude that FDI has a significant positive effect on host country economic growth but similar to Borensztein et al (1998) the magnitude depends on host country conditions."

Four of the eight studies cited in Johnson (2005) above found that FDI had a positive effect on host country economic growth. Three of these studies reached the conclusion that the magnitude of the FDI effect depends on host country conditions such as human capital abundance

and macroeconomic stability. The other four studies such as Choe (2003) found little evidence of FDI affecting growth.

It is worth noting that the above results may be divergent due to the research approach. For example, four of the studies pooled data for developed and developing economies. Interestingly, these pooled studies include three of those studies that did not find a link between FDI and economic growth. Blonigen (2004) argues that it is inappropriate to pool developing and developed economies when investigating the link between FDI and economic growth. Using the original data from Borensztein et al. (1998) and adding observations from developed economies, Blonigen (2004) explored the result of pooling developed and developing economies. When pooling the data, the statistically significant effect of FDI on growth disappears. The result puts into doubt all studies using pooled data, such as those conducted by Olofsdotter (1998), De Mello (1999), Carkovic and Levine (2002) and Choe (2003). The discussion in Blonigen (2004) suggests that while Balasubramanyam, et al. (1996), Borensztein et al. (1998) and Zhang (2001) have empirically proven that there is a statistically significant positive relationship between FDI and economic growth, the same cannot be said for Olofsdotter (1998), De Mello (1999), Carkovic and Levine (2002) and Choe (2003) as there is doubt over the pooling method.

In summation, the qualitative literature review suggests that the results of whether FDI causes growth are divergent because of how the research was conducted. However, Blonigen (2004) posits that there is a statistically significant positive relationship between FDI and economic growth. There is also enough empirical quantitative evidence of this causation as evidenced in Table 2.5. Table 2.5 shows that countries that have high FDI stock per capita also have high growth rates. The table

illustrates that the East Asian economies have experienced high growth the last two decades. Among the ten fastest growing economies in the world, five are located in East Asia.

Table 2.5 illustrates, high and low-growth developing economies and respective inward FDI stock.

High Growth Economies	Ave. Annual growth 1998 - 2002	stock per capita in 2002,
China	8.2	0
Korea	5.7	918
Botswana	4.8	499
Thailand	4.6	570
St Kitts and Nevis	4.6	14222
Singapore	4.4	32634
Antigua and Barbuda	4.1	9465
Cyprus	4	6348
Hong Kong	4	53968
Malta	3.8	0
Low Growt Economies	Ave. Annual growth 1998 - 2002	stock per capita in 2002,
Congo, Dem Rep.	-4.6	16
Liberia	-2.8	835
Sierra Leone	-2.8	5
Saudi Arabia	-2.5	1159
Haiti	-2.4	27
Ivory Coast	-2.3	224
United Arab Emirates	-2.1	957
Niger	-2	37
Madagascar	-2	26
Venezuela	-1.5	1264

Source: Based on data from UNCTAD (2004) and population data from World Development Indicators

Table 2.5 also shows that the sub-Saharan African economies have largely failed in achieving economic growth. Six of the ten worst performing economies are located in sub-Saharan Africa.

It is apparent from the literature, and as well as table 2.5 that economies which tend to have substantial inward stocks of FDI, seem to have high growth, and this is why the growth rate of Asian countries has been so incredulous, whilst that the sub-Saharan countries has been so dismal.

2.5 CONCLUSION

It is evident that the best kind of FDI is the kind that doesn't board a ship to another developing market when the going gets tough. For African developing countries to achieve their MDG, they require investments that are long term.

The past decade has witnessed a dramatic global increase in FDI to record highs of $1.411 trillion reached in 2000. The importance of FDI has superseded overseas development aid. A small number of fast-growing, East Asian, newly-industrialised economies such as China and India have become a case study of the success that awaits developing countries should they be able to attract FDI. These NIEs have shown that attracting FDI is a key factor to bridging the resource gap of low-income countries.

Attracting foreign direct investment (FDI) has thus assumed a prominent place in the strategies of economic renewal being advocated by African policy makers at national, regional and international levels. Africa is leading Asia in the number of policy reforms aimed at attracting FDI.

Regrettably, Africa has not yet benefited from the FDI boom despite its attempts to attract FDI. Africa desperately needs to attract FDI in order

to achieve the MDG goals. There is overwhelming evidence that FDI can affect growth endogenously, as it generates increasing returns on production via externalities and productivity spillover.

The findings of the reviewed literature suggest that even though Africa has made numerous positive policy changes, it is still seen by global investors to have poor economic policies, poor-quality services, closed trade regimes, and political illegitimacy.

African policy makers claim this to be Afro-pessimism or bad neighbourhood syndrome. Be that as it may, investors generally invest in geographic locations where they believe their investments are safe. This is the same approach that most people take when they invest in property. Any citisen would rather purchase property in a safer location than in a notoriously bad neighborhood even if it were at a premium cost.

Moreover, recent research has shown that FDI tends to cluster in particular locations. More specifically, FDI flows depend on a country's past stock of FDI; that is, countries that have been successful in attracting FDI in the past, are more likely to do so in the future. A well-run developing country that has quality infrastructure, political stability, and a minimum level of economic distortions is likely to attract FDI. However, a well-run region such as the Asian NIEs is likely to continually attract more FDI.

The fast-growing East Asian newly-industrialised economies such as China, have reinforced the credence that attracting FDI is key to bridging the resource gap of low-income countries and avoiding further build up of debt, while directly tackling the causes of poverty.

There is ample literature depicting whether or not FDI leads to economic growth. At face value, FDI is seen as a panacea to achieving economic

growth. There are many divergent views on whether or not FDI leads to economic growth. It is apparent from the literature reviewed that economies which tend to have substantial inward stocks of FDI, tend to have high growth, and this is why the growth rate of Asian countries has been so incredulous, whilst that of the sub Saharan countries has been so dismal.

The reviewed literature has set a foundation for a common definition of FDI. If Africa is to improve on its limited successes, and more importantly the lack economic growth, the understanding of the determinants that attract FDI become crucial.

CHAPTER 3

FOREIGN DIRECT INVESTMENT DETERMINANTS

3.1 INTRODUCTION

As the literature review has suggested, there is a statistically significant positive relationship between FDI and economic growth. This chapter aims to understand how developing countries such as those in the SADC region, can attract more FDI and thus increase their global share of FDI. This chapter goes on to identify the motives of TNCs as to why they invest where they do. More importantly, investigating what host country determinants are required by TNCs in order for them to invest. In order for FDI to take place, certain determinants should be in place.

Banga (2003, p.1) put forward that;

> "until recently, there was a strong consensus in the literature that Trans National corporations (TNCs) invest in specific locations mainly because of strong economic fundamentals in the host countries for example, large market size, stable macroeconomic environment etc (Dunning 1993, Globerman and Shapiro 1999, Shapiro and Globerman 2001). However, with the growing integration of the world markets and increased competition amongst the host countries to attract FDI, the host country's economic fundamentals may not be sufficient for inward FDI."

It now becomes important to study afresh what determines the inflow of FDI. In this regard, there is a need to focus on the role played by host government policies and investment agreements in attracting inward FDI. TNCs have many motives as to why they invest where they do, it is therefore key to put forward a FDI framework that caters for these different motives.

3.2 FOREIGN DIRECT INVESTMENT FRAMEWORK

The FDI framework is a blueprint that developing countries can follow to attract FDI. The UNCTAD (1998, p. xxvi) in reporting Dunning's study, explained that:

> "the differences in FDI performance among countries as well as tried to ascertain why firms invest where they do. It is necessary to understand how TNCs choose investment locations. Generally, FDI takes place when firms combine their ownership-specific advantages with the location-specific advantages of host countries through internalisation, i.e. through intra-firm rather than arm's-length transactions."

Three broad factors determine where TNCs invest:

> "the policies of host countries, the proactive measures countries adopt to promote and facilitate investment, and the characteristics of host country economies. The relative importance of different location-specific FDI determinants depends on the motive and type of investment, the industry in question, and the size and strategy of the investor. Different motives, for example, can translate into different location patterns depending on the investor's strategy (World Investment Report, 1998)."

It is therefore crucial for the SADC countries that are hoping to attract FDI to understand what determinants drive TNCs and ultimately FDI to specific host countries. Ahmed, et al. (2005, p.6) in reporting recent surveys of the empirical literature by Chakrabati (2001) and Kamaly (2002), suggest "that a few selected variables play a key role in a country's ability to attract FDI." They suggest that "the important variables are the host country's growth prospects, the openness of the host market, and the institutional environment." In addition, Ahmed, et al. (2005, p. 6) found that "a number of nontraditional variables, such as the quality of infrastructure, political stability, and the level of economic distortions, have also been found to affect FDI."

Overall, the results of Kamaly's 2002 empirical analyses (cited in Ahmed, et al., 2005, p. 6) suggest that a basket of different categories influence a country's attractiveness for FDI. "These include its macroeconomic performance, the investment environment, infrastructure and resources, the quality of institutions, and global factors." Moreover, recent research has shown that "FDI tends to cluster in particular locations. More specifically, FDI flows depend on a country's past stock of FDI; that is, countries that have been successful in attracting FDI in the past are more likely to do so in the future."

The above implies that well-run countries tend to attract FDI, and more importantly, FDI attracts more FDI. A well-run developing country should have quality infrastructure, political stability, and a minimum level of economic distortions. In general, this should be in place whether or not a country is seeking to attract FDI. SADC countries have in the past struggled to attract FDI, because the base fundamentals mentioned above were not in place. SADC countries that do not have sound base fundamentals will continue to find it difficult to attract FDI. Moreover, SADC countries that have not been successful in attracting FDI in the past are unlikely to do so in the future. This vicious cycle starts to explain why SADC countries have struggled and continue to struggle to attract FDI.

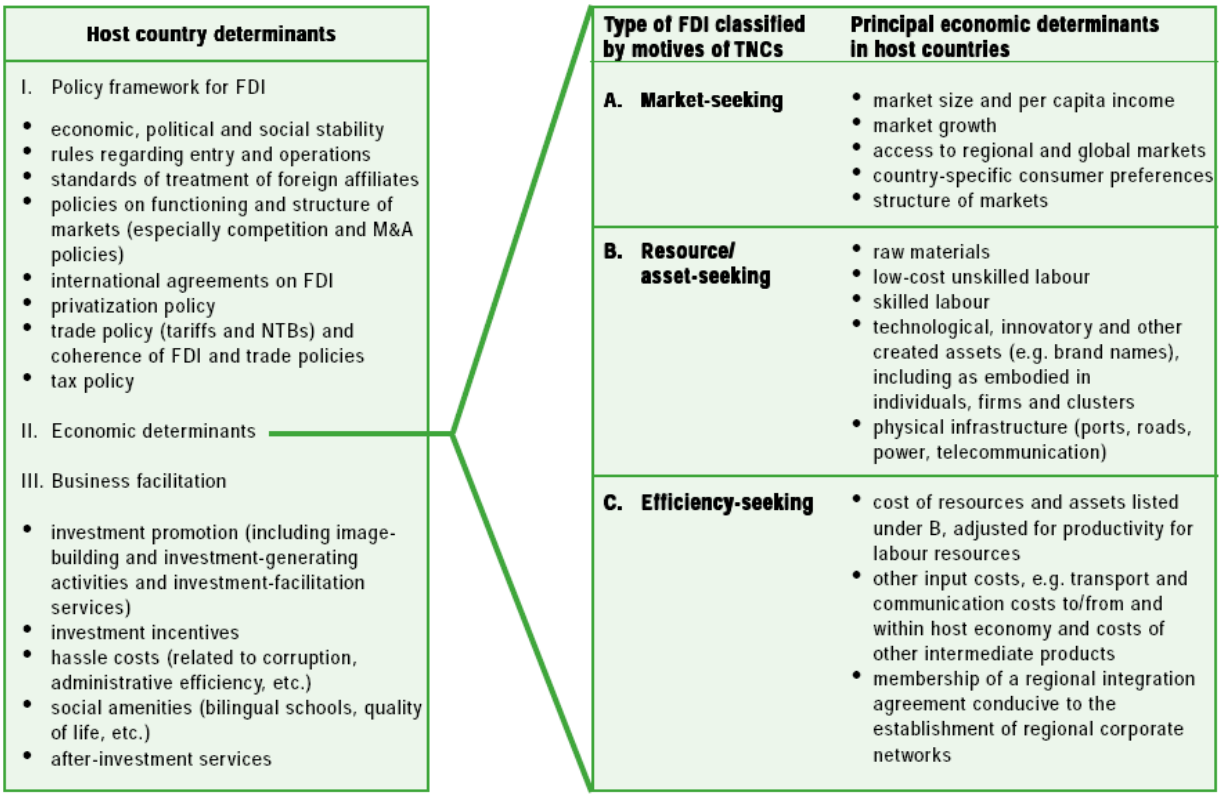
This literature suggests that there are key country-specific determinants that affect FDI. The supply side determinants of FDI are host country specific. This includes determinants such as political and macroeconomic stability and well-designed structural reforms. The demand side determinants of FDI depend on the motive and type of investment, the industry in question, and the size and strategy of the investor.

It can be hypothesised that if developing countries can comply with a certain framework that encompasses demand and supply side determinants for FDI, these developing countries should be able to attract more FDI and therefore achieve their economic growth imperatives.

In 1998 the World Investment Report, posited that host countries need to have the determinants listed below in order to attract FDI.

FIGURE 3.1: PROPOSED FOREIGN DIRECT INVESTMENT FRAMEWORK

Supply Side Determinants **Demand Side Determinants**



Source World Investment Report 1998

Figure 3.1 above illustrates that FDI operates under three main determinants;

- Policy Framework for FDI
- Economic Determinants
- Business Facilitation

The remaining part of this chapter will delve deeper into these determinants in an attempt to understand the environment in which FDI flourishes. The chapter will unpack the different variables under each determinant. This is to understand each variable's individual importance to the specific determinant, as well as its overall impact on the FDI framework.

3.2.1 POLICY FRAMEWORK FOR FDI

A key determinant of the FDI framework is policy. Policy implies all the rules and regulations that are put in place by the host country. Some of these rules are for the day to day running of the country, and others may be specific to enticing FDI. According to Nunnenkamp (2002, p. 19), policy includes heterogeneous variables such as economic and political stability, as well as regulations governing the entry and operations of trans-national corporations. The importance of policy as a core determinant is best illustrated by the obvious fact that FDI cannot take place unless it is allowed to enter a country."

It should be noted, however, that policy changes in the direction of openness have a different net result to policy restrictions. Policy changes in the direction of openness can only entice FDI, but cannot enforce it. Even when the policy change is very favourable, it cannot guarantee the

desired results. On the other hand, radically restrictive policies can pretty much guarantee the results (World Investment Report, 1998, p. 93).

The World Investment Report (1998, p. 93) continues to point out "that restrictive policies, such as sweeping nationalisations of foreign affiliates, can intentionally or unintentionally close the door to FDI." The policy framework for FDI is therefore a crucial prerequisite if a developing country endeavours to attract FDI. Whilst good policy cannot guarantee FDI, bad policy certainly can close the door to it. For a country to continuously attract FDI, it must adhere to best practice policies. This means that developing country governments need to have policies and laws in place that are welcoming to FDI. This makes TNCs feel that their investment would be safe in that prospective host country, and therefore the TNC may be induced to invest in that country with all things being equal.

3.2.2 ECONOMIC, POLITICAL AND SOCIAL STABILITY

According to Krugman and Obstfeld (Perrin and Sachwald, 2004, p. 28)

> "the goal of a macroeconomic policy is to maintain the internal and external balance of the macroeconomic system. The internal equilibrium refers to the full use of the factors of production and to price stability. The external equilibrium implies that the trade balance is high enough to allow the country to pay back its foreign debts. FDI is unlikely to flow to economically unstable countries as they do not offer a stable and predictable business environment."

Makola (2003 p.28) goes on to suggest that "political instability and unrest in Africa, rank most countries lower than expected index of 70. Some countries, such as South Africa, Botswana and Namibia, qualify but suffer because of 'bad neighbourhood' as referred to. The Africa continent is ranked low by investors as compared to Asia and Latin America."

In summary, the ideal situation for a host country is that there should be stability, as stability strengthens investor confidence. Hernandez-Cata's 2000 study (Matjekana, 2002, p. 24) suggests that "in the absence of stability any investment is likely to be accompanied by a high risk premium. Political risk such as armed conflict threatens the viability of growth-oriented programs."

3.2.3 RULES REGARDING ENTRY AND OPERATIONS

FDI generally goes to where it is most welcome, therefore countries that allow it to enter freely, are usually first choice. Because foreign firms are often more efficient than smaller local firms and have the resources to attract workers, this often antagonises the local industries (Makola M, 2003, p. 2). This has resulted in different approaches being adopted by host countries. The World Investment Report (2007, p. xxvi) elaborates that these approaches range from; "total prohibition of foreign investment in resource extraction (as in the case of oil in Mexico and Saudi Arabia) to almost complete reliance on TNCs (as in the case of metal mining in Ghana and Mali, or oil and gas extraction in Argentina and Peru)." Developing countries need to make sure that there are no rules and regulations that prohibit or limit the entry or even the exit of TNCs, as this will lead to TNCs taking their FDI to where it is welcomed.

3.2.4 STANDARDS FOR THE TREATMENT OF FOREIGN AFFILIATES

Once FDI has entered the host country in the form of TNCs, it must be treated equitably. A legal framework and a set of regulations must be put in place so as not to marginalise the TNCs. Host countries are often quick to protect their local industries. Protectionism by definition does not apply the principles of due process and fair and equitable treatment. Ideally, the opposite should apply as a way of incentivising the TNCs to invest in the host country; TNCs should be afforded protection privileges.

This has been emphasised by the World Investment Report (1998);

> "stating that host countries, including many developing countries, [should be] granting foreign investors legal protection and guarantees against non-commercial risks. The number of developing countries that have signed bilateral, regional and multilateral agreements dealing with the treatment and protection of FDI after entry has increased dramatically in the 1990s."

If a host country is to attract FDI, it is important that the policies and regulations employed by the host country do not marginalise TNCs. Marginalisation of TNCs is likely to dissuade them from entering a host country. However, favourable treatment of TNCs may induce and entice them to invest in that host country.

3.2.5 POLICIES ON FUNCTIONING AND STRUCTURES OF MARKETS

As mentioned above, in order for host countries to attract FDI, they must remove legislative obstacles that may deter FDI. However, just removing the legislative obstacles may not be sufficient. Developing countries need to have a functioning legal system, functioning financial services and a functioning ICT infrastructure in place. These functioning structures are required for TNCs to be able to conduct their daily business activities efficiently.

Host countries that have functioning and structured markets tend to attract more FDI, as TNCs favour and require transparency on how the markets work. More importantly, the structure makes it easy for the TNCs to trade in the local market. A well-functioning stock market, for example makes it easy for TNC to track host country currency fluctuations, as well market capitalisation of locally competing firms.

3.2.6 INTERNATIONAL AGREEMENTS ON FDI

A well-functioning host market makes it easy for TNCs to do business in the host country. However, TNCs need to be able to do business across borders as well. According to the UNCTAD (2003), governments need to remove cross-border barriers, including in the area of investment. Various international agreements that regulate these exchanges foster international cooperation.

Developing host countries thus need to ensure that policies undertaken at the national level in pursuit of specific development objectives, are enhanced, and not hindered by international rule making. Certain aspects of international rule making deserve particular attention from a development perspective. Hence, interest among developing nations in the context of international investment agreements, is likely and should focus on ways of enhancing their ability to attract desirable forms of FDI and to realise its potential benefits.

3.2.7 PRIVATISATION POLICY

The World Investment Report (1998) defines privatisation "as a special case of acquisition, as it involves purchases of firms from the state. It has two dimensions: an FDI-policy dimension and a competition-policy dimension. If privatisation welcomes foreign investors, it broadens the scope of FDI. "

The broader the scope of FDI, the more opportunities for the host country to attract FDI. The World Investment Report (2006) suggests "that the recipient developing country's business leaders, trade unions as well as policymakers may have to get used to an increased frequency of transactions. They particularly need to get used to transactions involving companies from developing and transition economies as acquirers of

domestic firms." Developing host countries therefore need to be careful in their use of legislation aimed at protecting national security interests, keeping in mind the risk of fuelling possible retaliation and protectionism.

3.2.8 TRADE POLICY

It was generally assumed by policy makers that openness to trade would in itself generate conditions conducive to the most efficient allocation of resources, irrespective of whether it is reciprocated or not. Akyuz (cited in UNCTAD, 2005, p. 77) disagrees, and is of the opinion that "such logic is dubious and its extension to FDI, in the context of bilateral and regional investment treaties and agreements should be approached with a good deal of caution."

African policy makers have woken up to this fact, and have rightly started expressing some serious reservations on these matters. This occurred most recently at the Third Session of the African Union Conference of Ministers of Trade held in Cairo in June 2005 (UNCTAD, 2005).

It is therefore important that developing host countries (DHCs) put policies in place that make conditions conducive to the most efficient allocation of resources, but these conditions must be reciprocated by the trading partner country.

3.2.9 TAX POLICY

Ngowi (Matjekana, 2002, p. 25) defines tax "to include tax exemptions such as tax holidays and wage-bill based tax deductions which can influence a firm's decisions on FDI." Under these types of determinants, a host of other incentives can be used. These incentives may be costly to the host country as they come in the form of tax breaks. A tax break to the TNC is revenue forgone for the host country. It is therefore

imperative that DHCs carefully consider the negative fiscal impact of these incentives as compared to the potential benefits of FDI.

Since there is a cost associated with tax incentives, DHCs therefore need to consider if they can afford these incentives. It may not be financially viable to offer tax incentives if the DHCs have other pressing socio economic development needs. The DHCs may be better off by focusing on all the other above-mentioned policy improvements.

In summary a developing host country must consider the policy framework within which FDI operates. FDI operates under a policy framework of solid economic, social and political stability. FDI is attracted to countries that have a strong legal framework regarding the entry and operations of TNCs. Moreover, TNCs are attracted to developing countries that have preferential standards of treatment to TNC, or at the very least, non-discriminatory standards to TNCs. International agreements and trade policies are also attractive to TNCs, as they give access to regional markets. Privatisation policies, as well as the tax policies help induce TNCs to host countries that offer favourable incentives, with all things being equal. Policy can be influenced by the host countr's governments.

African countries aiming to attract FDI, must have a mix of sustainable national economic policies, good-quality services, open trade regimes, and political legitimacy. Consequently, it is advisable for developing host country governments to redesign their macroeconomic, trade and industrial policies if they are to attract FDI.

As demonstrated in chapter two, FDI brings with it the creation of employment, managerial skills, and technology. Based on some African success stories, Basu and Srinivasan (cited in Ahmed, et al., 2005, p. 6)

posit that political and macroeconomic stability, well-designed structural reforms, and natural resources can contribute to an increase in FDI in countries.

Asiedu has stated that "African countries have a propensity to be less open than other emerging markets; are perceived as very risky; and, despite absolute improvements in the policy environment, they have lost ground relative to other regions."

Policy reform alone is not sufficient as evidenced by the numerous policy changes Africa has adopted that have not yielded increased FDI. Whilst developing countries can influence the policy changes there are however, host country specific determinants that cannot be influenced by government, this relates to natural endowments that are endemic to each host country.

3.3 HOST COUNTRY SPECIFIC ECONOMIC DETERMINANTS OF FDI

As host countries can influence policy, they have a level of control in attracting TNCs in that regard. When it however comes to host country specific determinants, they are limited by the country's natural resources.

Dunning (cited in Banga, 2003, p. 9) argues that FDI emerging from larger developing countries still seeks traditional host country economic determinants, e.g. resources, market size, and efficiencies."

It is therefore necessary that we understand what they are and how the host country specific determinants impact FDI.

3.3.1 RESOURCE-SEEKING FDI

Resource-seeking FDI can be defined as FDI that is motivated by the availability of natural resources in host countries. Historically, resource seeking FDI has always been important and remains a relevant source of investment and income for various developing countries. Globally, however, the importance of resource-seeking FDI has significantly decreased. According to the UNCTAD (1998, p. 106) "the share of the primary sector in outward FDI stocks of major home countries was below 5 percent in the first-half of the 1990s." This of course is largely due to the fact that the world has progressed from the industrial era to the information age.

Resource-rich developing host countries have always preferred FDI as it brought with it skills, capital and technical expertise that the DHC required to extract the natural resources. Nunnenkamp (2002) supports this by saying "FDI tends to give way to joint ventures, non-equity arrangements with foreign investors and arm's-length trade relations when host countries are no longer constrained in terms of capital and technical skills and are, thus, able to set up competitive indigenous enterprises". At that time, this was a symbiotic relationship. The host countries needed the skills and capital to extract the raw minerals, and the TNCs had the skills and resources to do the extraction. More importantly, the TNC home countries needed the minerals for their industrial endeavours.

Resource seeking FDI was the fundamental source of FDI in most developing countries. However, this changed as the world shifted from the industrial era, and globalised into the information era. However, the wheel is turning again due to natural resources having become very

important for Chinese and Indian TNCs. The security of supply of raw materials is deemed essential for China and India's rapidly growing economies. As a result of this new surge of resource-seeking TNCs, resource-rich DHCs can now look at attracting FDI not only from developed countries, but also from developing countries. Of course, not all countries are rich in natural resources such as oil, gold, diamonds, etc. Other DHCs are rich in land or market size.

3.3.2 MARKET-SEEKING FDI

Market seeking FDI has replaced resource seeking FDI as the key reason as to why TNCs invest abroad in a globalised world. SADC countries need to understand why TNC undertake investment abroad to produce the same goods as they produce at home. Kindleberger (1969, p. 13) suggested the reason for this was:" For direct investment to thrive there must be some imperfection in markets for goods or factors; including among the latter technology, or some interference in competition by government or by firms, which separates markets". The market imperfection hypothesis was postulated by Hymer (cited in Banga, 2003, p. 8) who stated that "FDI is the direct result of an imperfect global market environment."

Firms that invest abroad, generally have a competitive and or comparative advantage over the host country firms, with the result that they want to exploit this advantage. These competitive advantages differ from firm to firm, but they generally include management, sales and marketing, technology, product as well as R&D skills. It is therefore very important to understand the contributing reasons as to why firms enter different foreign markets.

For SADC countries to succeed in attracting FDI, they must understand that market-seeking FDI is by far the most common type of strategy by TNCs for developing countries. This is confirmed by the UNCTAD global survey, with 51% of respondents citing market access as the most significant motive for FDI, including TNCs from South Africa, in developing host countries (70% of all responses), as well as Indian and Chinese TNCs. Market-seeking FDI is common in most industries, although there is some variation, depending on the source country (World Investment Report, 2007).

Unfortunately for Africa, a prominent legacy of its colonial history is the predominance of small countries thirty one countries have a population of 10 million or less, and most of these have less than 5 million. Contrast this with Asia where China and India have populations of over a billion (UNCTAD, 2005). Given the importance of market size in attracting FDI, this is a potentially significant constraint on inflows into Africa. Africa also has the added challenge of having 54 governments, with many different languages.

To improve its chances of attracting FDI, small developing African countries therefore need to join together to form a region. Regionalisation such as with the SADC countries, has improved the chances of attracting market-seeking FDI. It must be noted however that for regionalisation to work, all the countries within the region must practise good governance. It takes only a few countries within a region not to tow the line for international investors to view the whole region as bad neighbourhood. Belonging to a good regional block has great benefits for all countries involved, although each country still needs to compete individually for FDI. Improving efficiencies is one comparative advantage

that can be explored by developing countries seeking to improve the flows of FDI.

3.3.3 EFFICIENCY-SEEKING FDI

With the rising integration of the world markets, as well as the regionalisation as explained above, the need to explain FDI that occurred even with greater access to integrated markets developed. A new theory that explained FDI in terms of a need to internalise transaction costs so as to improve profitability, came to the fore. This theory explained the emergence of "efficiency-seeking" FDI. This model also best explains why India and particularly China are currently the FDI darlings. The cost of efficient and skilled labour in India and China is by far cheaper compared to other developing countries.

Deyo and Ritchie (cited in Miyamoto, 2003, p. 23) put forward:

> "cross-country evidence that indicates that human capital as an important determinant for inward FDI. This is especially among efficiency-seeking TNCs, while not being an important determinant among market or resource-seeking TNCs. This is consistent with evidence that none of the Southeast Asian countries had institutions for industrial upgrading with skills development before the influx of FDI, at least in the low-end manufacturing sector. This evidence suggests that DHCs that may not have natural resources such as mineral resources or land in the case market seeking FDI, may manufacture a "natural resource"; i.e. skilled or cheap labour."

Because of globalisation, geographically dispersed manufacturing is possible. This means that the value chain can be segmented to a combination of markets. TNC can now outsource different parts of their value chain to different host countries that have different competencies and comparative advantages. Ease of trade is a key attribute of the world economy.

Nunnenkamp (2002, p. 25) defines efficiency-seeking FDI as being motivated by fims finding new sources of competitiveness and strengthening existing ones. Nunnenkamp believes that efficiency-seeking FDI may emerge as the most central type of FDI.

Accordingly, the competition for FDI would be based increasingly on cost differences between locations, the quality of infrastructure and business-related services, the ease of doing business and the availability of skills. Put differently, the challenge is to create assets that can provide a competitive edge ranging from human capital formation to the provision of business-related services such as efficient communication and distribution systems. Developing countries which were to restrict imports of capital goods and intermediate products, will not be integrated into international sourcing and marketing networks of TNCs (Nunnenkamp, 2002, p. 25).

In summation, the above understanding of the TNC's motive to invest abroad is crucial for attracting FDI to developing countries, as it potentially explains why certain developing countries are favoured over others. Historically, the three tenet determinants have been resource-seeking, market-seeking and later efficiency-seeking FDI. In the industrial era resource-seeking FDI was paramount as the colonialists had skills, capital and expertise, whereas the host countries had the natural resources with no capacity to extract them. However, the world has changed and as such moved from the industrial era and globalised into the information era. Fortunately for Africa, the tide is turning again due to natural resources having become very important for NIEs. As a result of resource rich areas, DHCs can now look at attracting FDI not only from developed countries, but also from developing countries too.

Market-seeking FDI has replaced resource-seeking FDI as the key reason as to why TNCs invest abroad in a globalised world. For the SADC countries need to understand that for direct investment to thrive, there must be some imperfection in markets for goods or factors. For SADC countries to succeed in attracting FDI, they must understand that market-seeking FDI is by far the most common type of strategy by TNCs for developing countries. Unfortunately for Africa, a prominent legacy of its colonial history is the predominance of small countries. To improve its chances of attracting FDI, small developing African countries therefore need to join together to form a regional block. Regionalisation such as has taken place in SADC countries has, improves the chances of attracting market-seeking FDI.

Efficiency-seeking FDI is motivated by finding new sources of competitiveness and strengthening existing ones for firms. Nunnenkamp believes that efficiency-seeking may emerge as the most central type of FDI. He believes that within SADC host countries that differentiate themselves on the cost of doing business, the quality of infrastructure and business-related services, the ease of doing business and the availability of skills will succeed. SADC countries that create assets that can provide a competitive edge ranging from human capital formation to the provision of business-related services such as efficient communication and distribution systems, will outperform other competing countries for FDI.

3.4 INVESTMENT INCENTIVES

As mentioned before, developing countries cannot influence their resource endowment. They can however influence the country's policies with regards to TNCs and ultimately FDI. Another variable or determinant that developing countries can influence is investment incentives. It is important to restate that a good policy framework is imperative in order to attract FDI. If a country has a bad policy framework, no number of incentives would entice TNCs. A DHC that has a good policy framework, as well as investment incentives, is likely to attract more FDI than another DHC that only has good policy framework – all things being equal.

Several studies with respect to incentives find that fiscal incentives affect location decisions, especially for export oriented FDI, and other incentives seem to play a secondary role. Banga (2003, p. 19) questions these results with respect to the impact of incentives offered by host countries to inward FDI, and concludes that they are ambiguous in nature. Incentives must be viewed as a package, and this requires a more nuanced view.

With all things being equal, the impact of investment incentives on inward FDI flows can be expected to be positive. Therefore DHC that can afford to spend on these incentives, should do so.

3.4.1 HASSLE COSTS

Hassle costs are not an incentive, but a disincentive. Corruption is a global problem. However, DHC governments need to work harder in fostering the creation of legal and administrative structures that can provide confidence in both public and business relations.

Good administrative and legal systems that provide a transparent, stable and predictable investment climate, are of paramount importance for attracting investors. DHCs must play a role in providing or financing education on good business and institutional governance (UNCTAD, 2003).

Such assistance should include customs administrations and procedures, competition laws and policies, patent systems and other legal systems, financial services of various kinds, environment protection, and more. Hassle costs may not be a financial incentive to TNCs, but can be a cost-saving incentive to TNCs. Corruption is a big cost to TNCs worldwide and with all things being equal, TNC would most likely rather invest in a country that has little or less corruption than one that is notorious for it, such as Nigeria for example.

3.4.2 SOCIAL AMENITIES

DHCs in general can be inhospitable environments. Under such conditions, business facilitation factors less frequently addressed, may come to play a more important role in the competition for FDI. The World Investment Report (1998, p. 127) puts forward a number of

> "proactive procedures to facilitate international production that can be carried out fairly rapidly by national governments. By offering after-investment services, social amenities and other business facilitation services to foreign investors, national governments or sub-national authorities can attempt to influence TNC location decisions."

As most developing countries have poor or nonexistent infrastructure (whether it is an education system or a good healthcare system), these countries need to invest in social amenities to entice TNCs to set up companies. TNCs want to invest where their employees will be well taken care of.

3.4.3 AFTER INVESTMENT SERVICES

When the DHC has successfully enticed the TNCs, it becomes important to keep the TNC and therefore the FDI in the country. Under the pressures of competition for FDI in a globalising economy, Young and Hood (cited in UNCTAD, 1998, p. 101) advocate that

> "investment facilitation services have to be extended to include after-investment services, that is, services rendered to establish foreign affiliates regarding day-to-day operational matters. The reasons for the inclusion of these services in investment promotion efforts are twofold. One is the realisation that sequential investment (that is the reinvestment of earnings by established foreign affiliates) can be a significant source of FDI. In the case of United States foreign affiliates it can account for up to a half of the annual outflows of FDI. "

Moreover, there is a mounting awareness that the best way to attain new investors is to show them happy investors. Satisfied investors are the best evidence of a good investment climate in a host country, and they can help thus to attract other investors. As mentioned earlier, FDI tends to go to the same countries and regions consistently, as success breeds success. It is crucial that developing countries attract FDI and once they have done so, they do what it takes to keep it.

3.5 CONCLUSION

In the preceding chapters it was established that during the past three decades there has been an increase in global FDI, and that there is a link between FDI and the economic growth of developing countries. It was also established that Africa has not been successful at attracting FDI. This chapter endeavoured to define and understand both the supply and demand determinants of FDI.

This chapter posited a core-enabling framework for FDI. If applied correctly, this framework could be used by developing countries to successfully attract FDI. The framework consisted of fundamental determinants such as regulations governing entry and operations of foreign investors, standards of treatment of foreign affiliates and the functioning of markets. This framework looked at core FDI policies that affect and influence foreign investors' locational decisions directly or indirectly. This included policies such as the trade and privatisation policies. The policies are designed so that DHCs can influence where TNCs locate FDI. FDI will simply not take place where it is forbidden. It is also important for DHCs to understand that changes in FDI policies have an asymmetric impact on the location of FDI. Changes in the direction of greater openness may allow firms to establish themselves in a particular location, but there is no guarantee. In contrast, changes in the direction of less openness (especially if radical like nationalisations), will pretty much ensure a reduction in FDI. This can be applied to one SADC country, Zimbabwe. Zimbabwe's political, macroeconomic instability and mass nationalisation at the hands of a dictator provide an unwelcome environment for FDI.

A key take out from the FDI framework is that the supply side determinants such as policy can be influence by the developing country

governments; however there are also demand side determinants that the developing countries can not influence. Location specific determinants such as resources, market size, as well as efficiencies, are mostly beyond the realm of control of DHCs. Even though DHCs cannot control these determinants it is a fact that good policy can go a long way to influencing some of these non-controllable determinants. A good policy on regional integration, can for example change a key economic determinant such as market size. Policy coherence is particularly important for efficiency-seeking FDI as firms integrate their foreign affiliates into international corporate networks. TNCs are likely to invest in countries that have efficient legal systems, minimal corruption and good infrastructure and capable governance.

The FDI Framework also suggests that, with all things being equal, good policy alone may be insufficient to attract FDI. With more DHCs transforming their policies to globally acceptable standards, it has resulted in the similarity of investment policies. Business facilitation measures become integral in DHC differentiation. The World Investment Report (1998, p. xxviii) indicates that whilst these measures are not new, they have proliferated as a means of DHC's competing for FDI, as FDI policies converge towards greater openness. Furthermore, business facilitation measures have become more sophisticated, increasingly targeting individual investors. Among these measures, after-investment services can be singled out because of the importance of reinvested earnings in overall investment flows. Satisfied investors are the best testament for a country's business climate.

Financial or fiscal incentives are also used to attract investors, however they typically only enter location-decision processes when other principal determinants are in place (World Investment Report, 1998). The

challenge with fiscal incentives is that they can be costly, particularly for a DHC. The cost is generally revenue forgone in tax breaks given to the TNCs. Fiscal incentives can indeed entice FDI but certainly cannot guarantee it.

If DHCs are to be successful at attracting FDI they need to apply the FDI framework as blueprint in the same way one would use a blueprint to build a house or building. They blue print works as a guide and like in all blue prints there are things that are nonnegotiable and must be included in the structure in order to have the desired end product. A building must have a foundation, walls, windows, doors, plumbing, electricity, a roof, etc. In the same way, the FDI framework proposes that there are certain fundamental determinants that need to be in place if a DHC is to be successful in attracting FDI. This includes economic, political and social stability, as well as rules regarding entry and operations of foreign affiliates.

In building a house there are variables that one cannot easily control or that are not under direct control. Once the land has been purchased, there is not much that can be done to increase its size. The efficiency of the municipality or utility company is not under direct control of the property owner.

Similarly, the demand side determinants such as resource seeking, market seeking and efficiency seeking FDI cannot easily be influenced by the DHC. Not every DHC has natural resources; market size is limited by the target population. DHCs may have an influence on country efficiencies, but this may take time and capital.

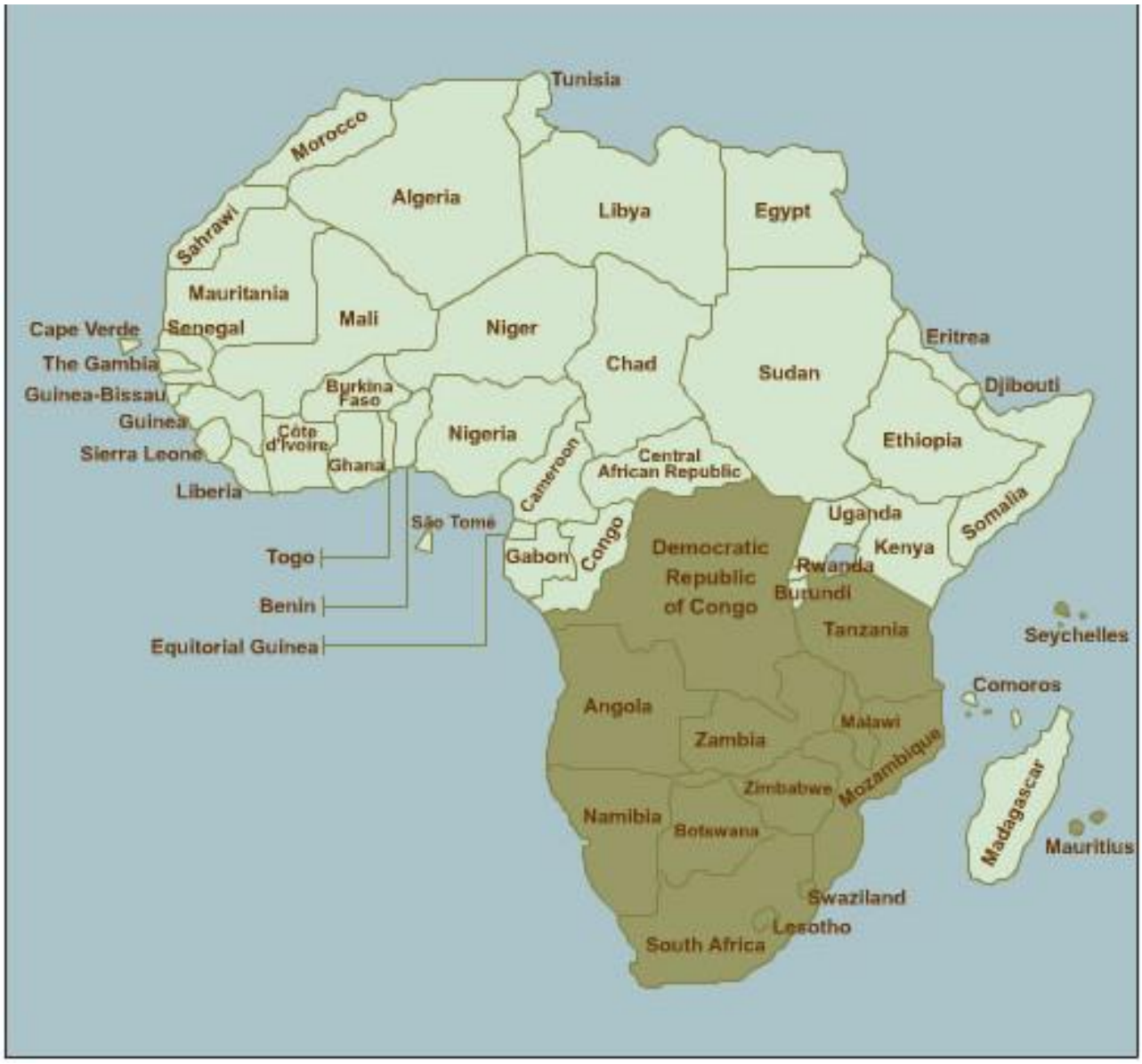
The other aspects of a building may be ideal but not essential, this would include the swimming pool, tennis court, etc. These amenities make the

house more attractive to prospective buyers. In the same way this would apply to DHCs that have business facilitation. DHCs that offer investment incentives, social amenities and after-investment services are more likely to entice TNCs to invest.

Now that FDI framework has been defined, it needs to be applied to SADC countries. The framework will be used to analyse the SADC host countries in an attempt to demonstrate that SADC countries that score well in the FDI framework, tend to attract more FDI than those that score low.

CHAPTER 4

CASE STUDY ANALYSIS OF FDI IN SADC HOST COUNTRIES



4.1 INTRODUCTION

This chapter takes the FDI framework literature unpacked in chapter three and applies it to the SADC developing countries. The aim of this chapter is to confirm that SADC countries that score high in the FDI framework tend to attract more FDI than those that score low. This chapter will look at SADC countries that have consistently attracted the most FDI in terms of FDI inflow, FDI stock and FDI stock as percentage of GDP. A further analysis will then be conducted as to how these countries fare with regard to FDI framework on policy, business facilitation as well as natural determinants.

As mentioned in the previous chapters, empirical evidence suggests that Africa gets the lowest proportion of global FDI flows. The challenge for SADC is to review its position and intensify its efforts to improve the economic environment so that it becomes an attractive destination for FDI flows. An analysis of the performance of a number of FDI determinants in the SADC region can help identify areas that need serious attention. This chapter identifies these factors and how they hinder efforts to attract FDI.

4.2 COMPARATIVE FDI FLOWS IN SELECTED SADC COUNTRIES

Pfefferman (as cited in Mafusire, 2002, p. 3) demonstrates that there were high FDI inflows within the developing countries in the 1990s. Comparatively, SADC constitute a very small proportion (about 2 –3% over the 1995 – 1999 period) of the global flows (see Table 4.1). However, this is a significant increase when compared to a 1.22% share for the 1983 – 1987 periods. Despite these favourable developments, it is

important to note that there are significant differences in FDI amounts that individual countries receive. For example, FDI inflows to South Africa and Angola are by far more significant than those of the other SADC countries.

Table 4.1 FDI Inflows to SADC countries in Millions of Dollars

YE.AR	1980	1985	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
World	54945	57596	202782	160199	171199	227532	259696	330516	386140	478082	694457	1088263	1491934	735146
Developed countries	46530	42693	164575	113099	107288	137153	144686	203311	219908	267947	484239	837761	1227476	503144
Western Europe	21427	16762	96803	80112	72201	74432	82481	118265	115863	137890	274739	507222	832067	336210
Developing countries	8380	14873	37567	44396	59238	83294	108699	112537	152685	191022	187611	225140	237894	204801
Africa	380	2407	2483	3307	3840	4420	6127	5743	5835	10744	9021	12821	8694	17165
North Africa	140	1422	1156	915	1674	1798	2396	1318	1479	2607	2788	4896	2904	5323
Angola	37	278	-335	665	288	302	170	472	181	412	1114	2471	879	1119
Botswana	112	54	96	-8	-2	-287	-14	70	70	100	96	37	57	57
DRC	110	69	-14	12	-1	7	-2	-22	25	-44	61	11	23	32
Lesotho	4	4	87	174	211	254	273	275	286	269	262	163	119	118
Malawi	9	1	23	18	2	11	9	25	44	22	70	60	45	58
Mauritius	1	8	41	19	15	15	20	19	37	55	12	49	277	12
Mozambique	4	0	9	23	25	32	35	45	73	64	235	382	139	255
Namibia	-	16	30	120	118	55	98	153	129	84	77	111	15`3	99
Seychelles	10	12	20	20	9	19	30	40	30	54	55	60	56	34
South Africa	-19	-453	-78	248	4	10	380	1241	818	3817	561	1502	888	6653
Swaziland	26	12	30	82	87	72	63	44	22	-15	152	100	-19	69
Tanzania	5	15	0	0	12	20	50	150	149	158	172	183	193	224
Zambia	62	52	203	34	45	314	40	97	117	207	198	163	122	72
Zimbabwe	2	3	-12	3	19	38	41	118	81	135	444	59	23	5
SADC	363	70	99	1410	833	862	1193	2727	2059	5319	3511	5352	2956	8807

Source: UNCTAD Database http://stats.unctad.org/fdi/eng/TableViewer/wdsview/dispviewp.asp

FDI inflows are vital in identifying which of the SADC countries are popular in attracting FDI, in other words FDI inflows tell us the volume of FDI transactions that above-mentioned SADC countries take part in.

Table 4.2 shows the FDI stocks available to the economies of the region. South Africa records the highest stocks by far throughout the years 1985, 1990, 1995, 1999 and 2000.

In fact, in the years 1999 and 2000, South Africa had FDI stocks to the value of more than four times that of the other SADC members combined. The second country recording some notable FDI stocks is Angola. Both the FDI stocks of South Africa and Angola show growth over the same period. Both Angola and South Africa are resource rich countries.

Table 4.2

FDI STOCKS IN SADC COUNTRIES FOR THE PERIOD 1985 TO 2000 (BILLION US$)

IN BILLIONS US$	1985		1990		1995		1999		2000		TOTAL	
COUNTRY	IN	OUT	IN	OUT	IN	OUT	IN	OUT	IN	OUT	IN	OUT
South Africa	9	9	9.2	15	15	23.3	51.8	33	52.7	33.6	137.7	113.9
Angola	0.7		1		2.9		7.1		8.9		20.6	0
Namibia	2		2	0.08	1.7	0.02	1.5	0.039	1.6	0.041	8.8	0.18
Zambia	0.4		1		1.3		1.9		2.1		6.7	0
Lesotho	0.026		0.2		1.3		2.3		2.5		6.326	0
Botswana	0.9	0.4	1.3	0.4	1.1	0.7	1.4	0.6	1.2	0.5	5.9	2.6
DRC	0.5		0.6		0.6		0.6		0.6		2.9	0
Zimbabwe	0.2	0.01	0.1	0.1	0.3	0.1	1.1	0.2	1.1	0.2	2.8	0.61
Tanzania	0.1		0.1		0.3		1		1.2		2.7	0
Mozambique	0.017		0.042		0.202		0.933		1.072		2.266	0
Swaziland	0.1	0.009	0.3	0.038	0.5	0.136	0.6	0.095	0.4	0.095	1.9	0.373
Seychelles	0.1	0.044	0.2	0.1	0.3	0.1	0.5	0.1	0.6	0.1	1.7	0.444
Mauritius	0.037		0.2	0.002	0.3	0.1	0.4	0.1	0.7	0.1	1.637	0.302
Malawi	0.1		0.2		0.2		0.4	0.011	0.5	0.015	1.4	0.026
SADC TOTAL	14.18	9.463	16.442	15.72	26.002	24.456	71.533	34.145	75.172	34.651	203.329	118.435
% OF WORLD	1.59	1.34	0.87	0.92	0.89	0.85	1.38	0.68	1.19	0.58	5.92	4.37
World	893.6	707.8	1888.7	1717.4	2937.5	2879.4	5196	5004.8	6314.3	5976.2	17230.1	16285.6

Source: UNCTAD 2001

Alarmingly, no other countries show any meaningful FDI stocks in dollar terms. However, before making any meaningful conclusions FDI stocks may be insufficient comparative indicators as to the success of the individual SADC countries in attracting FDI. This is due to the economies

of the SADC countries that are not all the same size. So this comparison may not reflect a comparative picture. Only when the FDI stocks are expressed as a percentage of GDP, can a sensible comparison be dawn as indicated in Table 4.3.

Table 4.3

FDI STOCKS AS A PERCENTAGE OF GROSS DOMESTIC PRODUCT IN SADC COUNTRIES FOR THE PERIOD 1985 TO 2000

	1985		1990		1995		1999		TOTAL	
COUNTRY	IN	OUT	IN	OUT	IN	OUT	IN	OUT	IN	OUT
Lesotho	10.3		24.9		157.7		262.7		455.6	0
Namibia	137.2		83.8	3.3	51.2	0.6	49.4	1.3	321.6	5.2
Seychelles	62.1	25.9	55.4	16.6	63.3	18.5	95.5	23.6	276.3	84.6
Angola	9.9		13.2		57.7		121.1		201.9	0
Botswana	78.1	36.3	38.7	13.2	24.6	14.2	23.1	10	164.5	73.7
Swaziland	28.9	2.4	39.1	4.5	42.2	10.7	45.7	7.8	155.9	25.4
Zambia	18.9		30		35.9		58.4		143.2	0
DRC	22.4		20.3		27.9		26.9		97.5	0
South Africa	16.3	16.2	8.6	14.1	11.2	17.4	39.5	25.2	75.6	72.9
Malawi	12.2		10.2		17.1		24.5	0.6	64	0.6
Mozambique	0.5		2		10.4		22.4		35.3	0
Zimbabwe	3.3	0.2	1.4	1	4.8	1.9	18.6	4.1	28.1	7.2
Mauritius	3.5		6.2		6.3	2.4	9.6	2.8	25.6	5.2
Tanzania	1.3		2.2		7		11.2		21.7	0
World	7.8	6.4	9.2	8.6	10.2	17.3	16.7	16.7	43.9	49

Source: UNCTAD 2001.

Table 4.3 above shows the value of FDI stocks in the domestic economy expressed as a percentage of the size of the economy. This gives us a more holistic comparative picture as to which SADC country is doing well in attracting FDI, regardless of the size of its economy. Looking at the value of FDI stocks as a percentage of GDP, it can be deduced that in eleven of the SADC economies FDI has been increasing. Only Botswana, the Democratic Republic of the Congo and Namibia show a declining tendency in FDI stocks as a percentage of GDP.

Since measuring FDI stocks as a percentage of GDP allows us to measure like with like, we can immediately observe which SADC countries are doing well in attracting FDI. For example Lesotho, Angola, the Seychelles and Zambia's FDI stock as a percentage of GDP has increased by more than 50 per cent between 1985 and 1999. In fact, Angola and Lesotho recorded 121.1 and 262.7 percent respectively; while the Seychelles had 95.5 per cent increase. This indicates the significant role that FDI plays in these economies, as well as the comparative success the SADC countries have had in attracting FDI. It is evident that the SADC region has had limited success in attracting FDI.

4.3 THE SADC REGION'S LIMITED SUCCESSES IN ATTRACTING FDI

The SADC has had limited success in attracting FDI despite the many policy changes aimed at attracting FDI. Asiedu (cited in Ahmed, et al., 2005, p. 6) shows that a number of factors explain Africa's limited success in attracting FDI. African countries tend to be less open than other emerging markets and are perceived as very risky. Despite major improvements in the policy environment, African countries have lost ground relative to other regions. Rogoff and Reinhart (also cited in Ahmed, et al., 2005, p. 6) argue that a high incidence of regional conflicts, high and volatile rates of inflation, and frequent currency crashes play an important role in explaining why Africa lags behind other regions in attracting FDI. Based on some African success stories, Basu and Srinivasan (cited in Ahmed, et al., 2005, p. 6) posit that political and macroeconomic stability, well-designed structural reforms, and natural resources contributed to an increase in FDI in these countries.

Studies by Haque, Nelson and Mathieson as well as Asiedu (Day, et al., n.d., p. 3) indicate that being situated in Africa, has a big influence on the amount of FDI that flows into the country.

These studies imply that, since Africa has challenges that are primarily peculiar to Africa, African policy makers should then focus more on the congruency between Policy Framework for FDI, Economic Determinants and Business Facilitation. African policy makers cannot just focus on the policy changes alone. African policy makers must realise that changing policy framework at national level without making the relevant adjustments and changes also the local and business level, will not yield the desired results. Put differently, developing host countries cannot just have national policies that attract foreign investors but when TNCs arrive, they find that barriers of entry such as Hassle Cost are high or there are no social amenities for the TNC's expatriates and their families.

More importantly, there must be congruency between the national policies and the reasons why TNCs would want to enter that particular host country. The national policies must therefore enhance the comparative and competitive advantage of that host country. If the host country is a resource rich country, then the national policies must be such that they enhance this fact. The national policies must be attractive to the resource seeking TNCs.

Finally, congruency must exist between all three, Policy Framework for FDI, Economic Determinants and Business Facilitation.

- Host countries must first know what they have to offer – Supply side.
- They must then know what their target TNCs are seeking – Demand Side

- They then have to formulate policies that attract the TNCs - Congruency

Once the TNCs have been attracted, it must be made convenient for them to do business. There is growing awareness that satisfied convenient investors are the best evidence of a good investment climate in a host country and therefore this situation can help to attract coninued investment, as well as other investors.

The Policy Framework and Business Facilitation are determinants that the host country has control over, whereas the Economic Determinants are host country specific and are dependent on what the TNC is seeking to achieve.

As discussed in chapter 3, recent surveys of the empirical literature by Chakrabati and Kamaly (Ahmed, et al., 2005, p. 6) suggest that a few selected variables play a key role in a country's ability to attract FDI. The most important variables are the host country's growth prospects, the openness of the host market, and the institutional environment. In addition, a number of nontraditional variables, such as the quality of infrastructure, political stability, and the level of economic distortions, have also been found to affect FDI.

Kamaly (Ahmed, et al., 2005, p. 6) concludes that "the overall results of the empirical analyses suggest that several broad categories of factors influence a country's attractiveness for FDI. These are its macroeconomic performance, the investment environment, infrastructure and resources, the quality of institutions, and global factors."

In addition, recent research has shown that FDI tends to cluster in particular locations. South Africa has had relative success in attracting

FDI comparative to other SADC countries. South Africa's success has had an impact on SADC FDI inflow.

4.4 THE SOUTH AFRICAN ECONOMY'S IMPACT ON SADC FDI

"The accession of South Africa, the Democratic Republic of Congo and the Seychelles to SADC membership during the 1990s saw the regional economy growing to more than $200 billion" (Mafusire, 2003, p. n).

Mafusire (2003, p. n) goes on to add that further efforts at greater integration following the Windhoek treaty of 1992 were expected to increase trade within the region. SADC's share of global FDI inflows increased from about 1.22% over the 1983/87 period to about 3% during 1995/99.

South Africa records by far the highest stocks of FDI throughout the years 1985, 1990, 1995, 1999 and 2000. In the years 1999 and 2000, South Africa had FDI stocks to the value of more than four times that of the other SADC members combined (Matjekana, 2002, p. 35).

Matjekana (2002, p. 31) has emphasised that

> "South Africa's size of the economy and the level of sophistication and economic diversification makes it very important to the region. Describing South Africa in the context of analytical evaluation of the SADC, BusinessMap SA (2000, p. 17) says that it is a "critical anchor for the SADC region, has the economic and political muscle to create a meaningful trade bloc. Sophisticated infrastructure and sound fiscal policy have encouraged stability of the investment climate."

Basu and Srinivsan (cited in Chitiga and Kandiero, 2002, p. 2) state that weak governance and poor infrastructure, are among some of the reasons why SADC countries are struggling to attract FDI. In contrast, it is interesting to note that despite this negative perception, resource rich SADC countries such as Botswana, Namibia and South Africa, continue to attract FDI, albeit negligible amounts. Resource endowments combined with economic reform have also contributed to Mozambique, Tanzania, Botswana and South Africa becoming attractive FDI destinations.

The African Development Report, (cited in Page and Velde, 2004, p. 22) shows that South Africa is the single largest African country investing in Africa. South Africa is the third largest foreign investor in Africa, following the UK (US$20 billion in 2002, 1.9% of total UK investment stocks) and the US (US$19.0 billion in 2003). Not only has the volume increased rapidly, the share of Africa in total outward FDI has also increased from 5 to 7%. It is also worth emphasising that 90% of South African FDI within Africa goes to Southern African, therefore neighbouring countries.

South African FDI is important for Southern African countries. According to the African Development Report (cited in Page and Velde, 2004, p. 22) South African FDI (accumulated over the period 1994-2003) represents the majority share of total inward FDI for countries such as Lesotho (86%) and Malawi (80%). South Africa is the leading foreign investor in seven SADC countries. The UNCTAD's *Investment Policy Review Botswana* states that in 1999 South African FDI was responsible for 49% of the inward FDI stock in Botswana, of which 60% was through a De Beers Diamonds subsidiary. In 2003, 25% of SADC FDI was from South Africa.

Table 4.4 below shows the distribution of South Africa's investment into other SADC countries. Between 1994 and 2003 South Africa was the

number one source of FDI in seven SADC countries, and was in the top three in all but one SADC country. This table shows South Africa's importance to the SADC region with regard to it FDI.

Table 4.4 South Africa's investment into other SADC countries:

Country	SA FDI as a percentage of total FDI in the country 1994 to 2003	SA ranking as foreign investor in the country
Lesotho	86%	1
Malawi	80%	1
DRC	71%	1
Swaziland	71%	1
Botswana	58%	1
Tanzania	35%	2
Mozambique	31%	1
Zambia	29%	1
Zimbabwe	24%	3
Namibia	21%	3
Angola	1%	6
Mauritius	-9%	3

Source: The BusinessMap Foundation, reported in Humphries (2004)

In summary, the significance of this empirical evidence is that South Africa has been the number one source of FDI in almost all the SADC countries. It is therefore crucial that South Africa increases its own inflows of FDI ,as this has huge ramifications to the countries that rely on South Africa for their FDI. Also, if the SADC region as a whole is to succeed, it cannot solely rely on South Africa for FDI. The entire region has to increase its share of global FDI. It is therefore important to understand what the world's TNC see as impediments to doing business in SADC. In order to find out what these impediments are, an empirical analysis on FDI determinants must be undertaken.

The FDI framework needs to be applied to the SADC countries to understand which determinants are impeding these countries from achieving the desired level of FDI.

4.5 EMPIRICAL ANALYSIS OF FDI DETERMINANTS IN SADC USING THE FDI FRAMEWORK

The FDI framework discussed in chapter three best illustrates the three determinants that attract FDI;

- Policy Framework for FDI
- Economic Determinants
- Business Facilitation

The results gathered from the World Business Environment (WBE) Survey will be applied to the FDI framework. The objective is to observe if:

- SADC host countries that have welcoming policies attract more FDI stock.
- Economic Determinants such as Resources, Market Access and Efficiencies attract more FDI stock.
- SADC host countries that have implemented business facilitation attract more FDI.
- The level of congruency that exists between the above three.

The World Business Environment (WBE) Survey was conducted by the World Bank in 1999/2000. It covered about 10,000 firms in 80 countries. The sample for SSA included 413 foreign firms in 16 countries. Respondents were asked to judge on a four point scale the extent to which a particular factor constrained their business operations in a country (1= no constraint to 4= severe constraint).

Constraints on FDI to Sub-Saharan Africa: .

WBE (1= no constraint, 4=severe constraint)	
Corruption	2.80
Weak Infrastructure	2.75
Street Crime	2.70
Inflation	2.67
Financing	2.64
Organized Crime	2.57
Political Instability	2.43
Taxes and Regulation	2.24
Exchange Rate	2.15

4.5.1 DETAILED RESULTS OF THE SURVEY

Unfortunately not all the SADC countries participated in this survey, and therefore the countries that did not supply data have been left out.

Policy Framework Questions

Question: How problematic are obstacles in the business environment in the following areas?
Policy Instability

Country	No obstacle	Minor obstacle	Moderate obstacle	Major obstacle	Weighted
Botswana	55.80%	35.10%	5.20%	3.90%	**3.428**
Namibia	50.60%	41.20%	5.90%	2.40%	**3.402**
South Africa	26.70%	53.30%	13.30%	6.70%	**3**
Malawi	20.90%	51.20%	20.90%	7%	**2.86**
Tanzania	22.80%	33.30%	22.80%	21.10%	**2.578**
Zambia	10%	42.90%	31.40%	15.70%	**2.472**
Zimbabwe	9.80%	29.40%	36.30%	24.50%	**2.245**

Question: How problematic are obstacles in the business environment in the following areas?

Financing

Country	No obstacle	Minor obstacle	Moderate obstacle	Major obstacle	Weighted
Namibia	36.80%	41.40%	20.70%	1.10%	**3.139**
Botswana	26.30%	35%	20%	18.80%	**2.69**
South Africa	19.60%	37.30%	28.40%	14.70%	**2.618**
Malawi	4.10%	32.70%	26.50%	36.70%	**2.042**
Zimbabwe	6.90%	24.80%	32.70%	35.60%	**2.03**
Tanzania	7.60%	15.20%	39.40%	37.90%	**1.927**
Zambia	5.50%	19.20%	37%	38.40%	**1.92**

Question: How problematic are the following regulations for the operation and growth of your business?

Labor regulations

Country	No obstacle	Minor obstacle	Moderate obstacle	Major obstacle	Weighted
Malawi	34.60%	46.20%	15.40%	3.80%	**3.116**
Botswana	35.40%	38.50%	16.70%	9.40%	**2.999**
Zambia	27.60%	32.90%	31.60%	7.90%	**2.802**
Namibia	16.70%	31.10%	40%	12.20%	**2.523**
Tanzania	12.20%	33.80%	35.10%	18.90%	**2.393**
Zimbabwe	3.40%	40.30%	28.60%	27.70%	**2.194**
South Africa	3.40%	11.80%	48.70%	36.10%	**1.825**

Question: How problematic are obstacles in the business environment in the following areas?

Inflation

Country	No obstacle	Minor obstacle	Moderate obstacle	Major obstacle	Weighted
Botswana	27.90%	51.20%	18.60%	2.30%	**3.047**
Namibia	24.70%	53.80%	16.10%	5.40%	**2.978**
South Africa	4.60%	53.70%	34.30%	7.40%	**2.555**
Tanzania	14.90%	25.40%	44.80%	14.90%	**2.403**
Zambia	0%	6.80%	34.20%	58.90%	**1.477**
Malawi	2.10%	4.20%	25%	68.80%	**1.398**
Zimbabwe	0%	0%	16.20%	83.80%	**1.162**

Question: How problematic are obstacles in the business environment in the following areas?

Exchange Rate

Country	No obstacle	Minor obstacle	Moderate obstacle	Major obstacle	Weighted
Botswana	76.70%	17.80%	4.10%	1.40%	**3.698**
Namibia	36%	42.70%	20.20%	1.10%	**3.136**
Zambia	38.70%	38.70%	16.10%	6.50%	**3.096**
Tanzania	29.50%	45.90%	16.40%	8.20%	**2.967**
Malawi	15.60%	40%	37.80%	6.70%	**2.647**
South Africa	14.60%	37.90%	37.90%	9.70%	**2.576**
Zimbabwe	4.20%	32.30%	34.40%	29.20%	**2.117**

Question: How problematic are Customs/foreign trade regulations for the operation and growth of your business?

Country	No obstacle	Minor obstacle	Moderate obstacle	Major obstacle	Weighted
Botswana	43.60%	44.70%	9.60%	2.10%	**3.298**
Namibia	41.80%	39.60%	13.20%	5.50%	**3.179**
South Africa	26.90%	51.30%	18.50%	3.40%	**3.019**
Zambia	27.30%	32.50%	31.20%	9.10%	**2.782**
Malawi	13.20%	34%	28.30%	24.50%	**2.359**
Tanzania	11.30%	22.50%	45.10%	21.10%	**2.24**
Zimbabwe	10.80%	22.50%	32.50%	34.20%	**2.099**

Question: How problematic are obstacles in the business environment in the following areas?

Taxes and Regulations

Country	No obstacle	Minor obstacle	Moderate obstacle	Major obstacle	Weighted
Botswana	34.10%	56.80%	9.10%	0%	**3.25**
Namibia	20.40%	68.80%	10.80%	0%	**3.096**
Malawi	10.20%	55.10%	34.70%	0%	**2.755**
Zambia	7.90%	51.30%	38.20%	2.60%	**2.645**
Tanzania	16%	34.70%	44%	5.30%	**2.614**
South Africa	4.60%	47.20%	46.30%	1.90%	**2.545**
Zimbabwe	2.90%	33%	59.20%	4.90%	**2.339**

Question: How problematic are the following regulations for the operation and growth of your business?

Tax regulations

Country	No obstacle	Minor obstacle	Moderate obstacle	Major obstacle	Weighted
Botswana	54.90%	34.10%	7.30%	3.70%	**3.402**
Namibia	28.10%	46.10%	18%	7.90%	**2.946**
South Africa	2.80%	50%	43.40%	3.80%	**2.518**
Malawi	12.20%	28.60%	40.80%	18.40%	**2.346**
Zambia	5.30%	28%	44%	22.70%	**2.159**
Zimbabwe	3.90%	29.40%	41.20%	25.50%	**2.117**
Tanzania	4.20%	16.90%	43.70%	35.20%	**1.901**

Question: How problematic are the following regulations for the operation and growth of your business?

High taxes

Country	No obstacle	Minor obstacle	Moderate obstacle	Major obstacle	Weighted
Botswana	62.80%	23.40%	7.40%	6.40%	**3.426**
Namibia	14.60%	22.50%	44.90%	18%	**2.337**
South Africa	6%	22.20%	53%	18.80%	**2.154**
Malawi	2%	13.70%	27.50%	56.90%	**1.61**
Zambia	2.60%	11.50%	24.40%	61.50%	**1.552**
Zimbabwe	3.30%	4.10%	23%	69.70%	**1.412**
Tanzania	3.80%	5.10%	19%	72.20%	**1.407**

4.5.2 BUSINESS FACILITATION OF FDI

Investment Promotion and Investment Incentives:

Question: How problematic are the following regulations for the operation and growth of your business?
Business licensing

Country	No obstacle	Minor obstacle	Moderate obstacle	Major obstacle	Weighted
Namibia	63%	28.30%	6.50%	2.20%	**3.521**
Malawi	50%	40.70%	9.30%	0%	**3.407**
Botswana	46.90%	38.50%	9.40%	5.20%	**3.271**
South Africa	44.90%	39.80%	11.90%	3.40%	**3.262**
Zambia	48.10%	29.90%	13%	9.10%	**3.172**
Zimbabwe	36.70%	30%	21.70%	11.70%	**2.919**
Tanzania	24.40%	29.50%	34.60%	11.50%	**2.668**

Hassle Costs:

Question: How problematic are obstacles in the business environment in the following areas?
Corruption

Country	No obstacle	Minor obstacle	Moderate obstacle	Major obstacle	Weighted
Namibia	46%	44.80%	9.20%	0%	3.368
Botswana	46.40%	42.90%	6%	4.80%	3.311
South Africa	6.50%	43%	34.60%	15.90%	2.401
Malawi	8.50%	38.30%	36.20%	17%	2.383
Zambia	4.20%	35.20%	40.80%	19.70%	2.237
Zimbabwe	5.70%	24.80%	47.60%	21.90%	2.143
Tanzania	3%	28.40%	41.80%	26.90%	2.077

Question: How frequently do firms in your line of business have to pay some irregular "additional payments" for any of the following?
To get things done

Country	Always	Mostly	Frequently	Sometimes	Seldom	Never	Weighted
Namibia	1.10%	3.40%	13.50%	4.50%	34.80%	42.70%	**2.034**
Botswana	4.30%	6.50%	6.50%	6.50%	26.90%	49.50%	**2.071**
South Africa	4.30%	7.80%	11.20%	15.50%	37.90%	23.30%	**2.552**
Malawi	3.80%	9.40%	24.50%	24.50%	22.60%	15.10%	**3.016**
Zambia	9.50%	10.80%	24.30%	24.30%	17.60%	13.50%	**3.298**
Zimbabwe	6.80%	18.80%	24.80%	25.60%	17.10%	6.80%	**3.518**
Tanzania	21.30%	25.30%	22.70%	13.30%	13.30%	4%	**4.156**

Question: How problematic are obstacles in the business environment in the following areas?
Organized Crime

Country	No obstacle	Minor obstacle	Moderate obstacle	Major obstacle	Weighted
Botswana	64.60%	13.10%	15.20%	7.10%	**3.352**
Tanzania	51.30%	26.30%	13.20%	9.20%	**3.197**
Namibia	27.70%	31.90%	16%	24.50%	**2.63**
Zimbabwe	28.60%	27.80%	20.60%	23%	**2.62**
Zambia	25%	21.40%	26.20%	27.40%	**2.44**
Malawi	13.20%	26.40%	24.50%	35.80%	**2.168**
South Africa	4.10%	11.60%	33.90%	50.40%	**1.694**

Question: How problematic are obstacles in the business environment in the following areas?
Street Crime

Country	No obstacle	Minor obstacle	Moderate obstacle	Major obstacle	Weighted
Botswana	33%	45.50%	20.50%	1.10%	**3.106**
Namibia	36.30%	36.30%	20.90%	6.60%	**3.025**
Tanzania	27.10%	44.10%	27.10%	1.70%	**2.966**
Zimbabwe	7.70%	41.30%	44.20%	6.70%	**2.498**
Zambia	4.20%	20.80%	51.40%	23.60%	**2.056**
Malawi	2.10%	29.20%	35.40%	33.30%	**2.001**
South Africa	0%	10.10%	23.90%	66.10%	**1.442**

Social amenities
Question: How problematic are obstacles in the business environment in the following areas?
Infrastructure

Country	No obstacle	Minor obstacle	Moderate obstacle	Major obstacle	Weighted
Namibia	55.80%	33.70%	10.50%	0%	**3.453**
South Africa	37.70%	48.10%	9.40%	4.70%	**3.186**
Botswana	25%	46.30%	25%	3.80%	**2.927**
Zimbabwe	9.20%	33.70%	46.90%	10.20%	**2.419**
Zambia	2.80%	20.80%	41.70%	34.70%	**1.917**
Tanzania	1.50%	10.30%	47.10%	41.20%	**1.723**
Malawi	2.10%	8.50%	25.50%	63.80%	**1.487**

Question: How would you rate the quality and efficiency of the following public services?
Roads

Country	Very good	Good	Slightly good	Slightly bad	Bad	Very bad	Weighted
Namibia	29%	52.70%	12.90%	5.40%	0%	0%	**5.053**
Botswana	14.70%	46.30%	28.40%	6.30%	2.10%	2.10%	**4.585**
South Africa	10%	54.20%	20%	9.20%	5%	1.70%	**4.503**
Zimbabwe	3.10%	17.30%	29.10%	13.40%	23.60%	13.40%	**3.223**
Tanzania	0%	5.10%	29.50%	21.80%	28.20%	15.40%	**2.807**
Zambia	2.50%	9.90%	18.50%	17.30%	35.80%	16%	**2.78**
Malawi	0%	3.70%	14.80%	24.10%	22.20%	35.20%	**2.296**

Question: How would you rate the quality and efficiency of the following public services?
Telephone

Country	Very good	Good	Slightly good	Slightly bad	Bad	Very bad	Weighted
Namibia	38.30%	41.50%	14.90%	5.30%	0%	0%	**5.128**
Botswana	22%	49%	15%	5%	7%	2%	**4.68**
South Africa	7.40%	49.60%	28.10%	9.90%	3.30%	1.70%	**4.428**
Tanzania	3.80%	43%	26.60%	12.70%	11.40%	2.50%	**4.076**
Zambia	2.50%	33.80%	30%	18.80%	12.50%	2.50%	**3.879**
Malawi	0%	15.40%	13.50%	17.30%	23.10%	30.80%	**2.599**
Zimbabwe	0.80%	8.70%	15.70%	17.30%	30.70%	26.80%	**2.512**

Question: How would you rate the quality and efficiency of the following public services?
Electricity

Country	Very good	Good	Slightly good	Slightly bad	Bad	Very bad	Weighted
Namibia	49.50%	44.10%	5.40%	1.10%	0%	0%	**5.424**
South Africa	33.10%	54.50%	9.90%	1.70%	0.80%	0%	**5.174**
Botswana	27.30%	45.50%	16.20%	9.10%	2%	0%	**4.874**
Zambia	8.60%	38.30%	25.90%	11.10%	13.60%	2.50%	**4.097**
Zimbabwe	1.60%	26%	22.80%	30.70%	13.40%	5.50%	**3.552**
Tanzania	2.60%	10.30%	42.30%	17.90%	19.20%	7.70%	**3.361**
Malawi	0%	5.80%	26.90%	26.90%	19.20%	21.20%	**2.769**

Question: How would you rate the quality and efficiency of the following public services?
Water

Country	Very good	Good	Slightly good	Slightly bad	Bad	Very bad	Weighted
Namibia	46.20%	46.20%	4.30%	3.20%	0%	0%	**5.35**
Botswana	23.20%	53.50%	16.20%	5.10%	2%	0%	**4.908**
South Africa	19.80%	57.90%	16.50%	4.10%	0.80%	0.80%	**4.89**
Zambia	3.90%	28.60%	24.70%	20.80%	14.30%	7.80%	**3.64**
Malawi	1.90%	19.20%	42.30%	17.30%	11.50%	7.70%	**3.592**
Zimbabwe	3.20%	26.40%	19.20%	22.40%	20.80%	8%	**3.448**
Tanzania	0%	3.80%	15.20%	35.40%	20.30%	25.30%	**2.519**

Water Question: How would you rate the quality and efficiency of the following public services?
Public health

Country	Very good	Good	Slightly good	Slightly bad	Bad	Very bad	Weighted
Botswana	9.30%	22.70%	49.50%	11.30%	5.20%	2.10%	**4.137**
Namibia	6.50%	32.60%	28.30%	18.50%	10.90%	3.30%	**3.958**
Tanzania	1.20%	3.70%	27.20%	30.90%	22.20%	14.80%	**2.864**
South Africa	0.80%	2.50%	21.70%	28.30%	36.70%	10%	**2.724**
Zambia	1.20%	2.40%	26.80%	14.60%	36.60%	18.30%	**2.617**
Malawi	0%	1.90%	24.10%	20.40%	22.20%	31.50%	**2.43**
Zimbabwe	0%	3.20%	11.10%	10.30%	37.30%	38.10%	**2.04**

Question: How would you rate the quality and efficiency of the following public services?
Education

Country	Very good	Good	Slightly good	Slightly bad	Bad	Very bad	Weighted
Botswana	9.30%	32%	48.50%	7.20%	3.10%	0%	**4.376**
Namibia	5.30%	36.20%	22.30%	28.70%	6.40%	1.10%	**4.02**
Zimbabwe	0.80%	16%	28.80%	20%	24%	10.40%	**3.184**
South Africa	0.80%	5.80%	30.60%	34.70%	24.80%	3.30%	**3.132**
Tanzania	0%	10.40%	27.30%	24.70%	19.50%	18.20%	**2.925**
Malawi	0%	7.50%	26.40%	26.40%	18.90%	20.80%	**2.809**
Zambia	1.30%	5.10%	17.70%	25.30%	35.40%	15.20%	**2.66**

4.6 ANALYSIS

Table 4.1 below summarises the results from the research above. This table looks at the individual country's success in attracting FDI inflows, FDI stock, as well as FDI as a percentage of GDP. This table seeks to illustrate the relationship between a good policy framework, business facilitation and the impact that resources have on FDI.

Table 4.1 Summary of results

Country	Policy	Facilitation	Resources	FDI Inflow	FDI Stock	FDI % of GDP	Total
Botswana	✓	✓	✓	↑	↘	↑	↑
Namibia	✓	✓	✓	↗	↑	↑	↑
South Africa	!	!	✓	↘	↑	↘	↑
Zambia	!	!	✓	↓	↗	↗	↗
Tanzania	!	!	✓	↘	↓	↓	↘
Malawi	!	✗	✗	↑	↓	↘	↓
Zimbabwe	✗	✗	✗	↓	↘	↓	↓

Source: Adapted from a number of tables UNCTAD 2001

This table's results will be discussed in detail below.

4.6.1 NATIONAL POLICY FRAMEWORK TO FACILITATE FDI

To put a country on their short list, TNCs consider two prerequisites. The first is the institutional background of an attractive investment climate. The second is more directly related to how easy it is to do business in that country. If these two prerequisites are met, then the country may be put on the short list.

4.6.1.1 THE INSTITUTIONAL BACKGROUND

For a country to be attractive as a an investment potential, a set of prerequisites has to be fulfilled: political and macroeconomic stability. This is the most important prerequisite for TNCs. Investors in general are deterred by risk; moreover, they need to be able to evaluate their investment return on a medium to long-term period.

A transparent, stable, and non-discriminatory legal and regulatory environment is also important for TNCs. Moreover, laws, regulations, and contracts must be followed. In cases of conflict, an efficient, non-corrupt judicial system is required.

As the World Business Environment survey has revealed, TNCs want a corruption free regime. Bureaucratic procedures and their usual informal "payments" (i.e., bribes) are no longer considered as the price to pay for having access to the domestic market. TNCs need free trade to maximise economies of scale generated by manufacturing in different sites and in various countries. Transaction costs have to be as small as possible however red tape tends to increase these costs. In the event of administrative procedures being too long and too complex, TNC will move to other more hospitable host countries.

**** Countries that fared well in this survey with regards to policy were; Botswana, Namibia and South Africa, in order of rating***

4.6.1.2 THE ECONOMIC AND SOCIAL BACKGROUND

The economic and social background is becoming primarily important when global TNCs are deciding what business to do in a country with a good institutional background. To be able to decide, TNCs compare what is needed to start a profitable activity, with what factors the country is offering. This is the way in which a comparative local advantage for FDI is defined.

A good infrastructure is key to TNCs. Countries that have a good telecommunication, electricity and water supply, tend to be better at attracting FDI. This infrastructure has to be reliable too, as it is not sufficient to have the access to telecommunication if the lines are constantly dropped or the quality of the lines is poor. Access to basic necessities such as water and electricity is important to TNCs from a business point of view as well as from domestic facilities. TNCs are generally from first-world countries, where these amenities are taken for granted. Street crime and overall security are also key concerns for TNCs. It is difficult to do business in countries where employees lives are in danger, or where the business assets are constantly stolen.

**** SADC countries that fared well with regard to business facilitation are Botswana, Namibia and South Africa in order of rating.***

4.6.2 THE MACROECONOMIC DETERMINANTS OF FDI

4.6.2.1 RESOURCE SEEKING

Fig 4.1

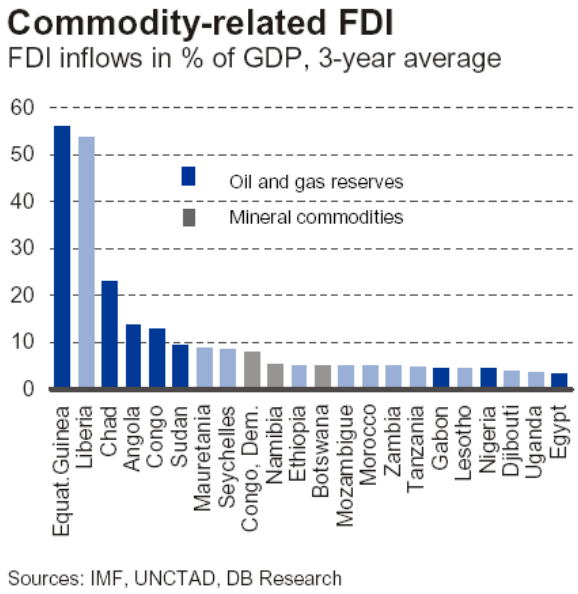


Figure 4.1 reveals that the attraction of Africa's natural resources accounts for the uneven spread of FDI flows across the continent. The 24 countries in Africa classified by the World Bank as oil- and mineral-dependent, have on average accounted for close to three-quarters of the annual FDI flows over the past two decades, and, with the exception of Mauritius, Morocco and Uganda, which featured among the top 10 recipients for some years during the period 1999–2003.

DEVELOPING-COUNTRY GROUPS: TOP 5 AND TOP 10 RECIPIENTS OF FDI, 1999–2003

Million dollars

1999		2000		2001		2002		2003		*Memo item:* Population share at 2001
Country/Region	*Value*	*Country/Region*	*Value*	*Country/Region*	*Value*	*Country/Region*	*Value*	*Country/Region*	*Value*	
Angola	2471	Egypt	1235	South Africa	6789	Angola	1643	Morocco	2279	_
South Africa	1502	Nigeria	930	Morocco	2825	Nigeria	1281	Equat. Guinea	1431	_
Egypt	1065	South Africa	888	Angola	2146	Algeria	1065	Angola	1415	_
Nigeria	1005	Angola	879	Algeria	1196	Chad	1030	Sudan	1349	_
Morocco	850	Tunisia	779	Nigeria	1104	Tunisia	821	Nigeria	1200	_
Tanzania	542	Algeria	438	Equat. Guinea	931	South Africa	757	Chad	837	_
Algeria	507	Sudan	392	Sudan	574	Sudan	713	South Africa	762	_
Congo	491	Tanzania	282	Egypt	510	Egypt	647	Libya	700	_
Mozambique	382	Mauritius	277	Tunisia	486	Morocco	481	Algeria	634	_
Sudan	371	Uganda	275	Tanzania	467	Botswana	405	Tunisia	584	_
	Per cent		**Per cent**		**Per cent**		**Per cent**		**Per cent**	**Per cent**
Top 5 to Africa	**59.5**	Top 5 to Africa	**54.0**	Top 5 to Africa	**71.7**	Top 5 to Africa	**49.6**	Top 5 to Africa	**51.0**	30.4
Top 10 to Africa	**79.3**	Top 10 to Africa	**73.0**	Top 10 to Africa	**86.8**	Top 10 to Africa	**75.1**	Top 10 to Africa	**74.4**	47.8
Top 5 to dev'g America	**88.3**	Top 5 to dev'g America	**87.6**	Top 5 to dev'g America	**84.9**	Top 5 to dev'g America	**81.5**	Top 5 to dev'g America	**77.9**	68.5
Top10 to dev'g America	**95.6**	Top10 to dev'g America	**94.8**	Top10 to dev'g America	**94.3**	Top10 to dev'g America	**92.0**	Top10 to dev'g America	**91.5**	84.8
Top 5 to dev'g Asia	**87.1**	Top 5 to dev'g Asia	**91.7**	Top 5 to dev'g Asia	**84.7**	Top 5 to dev'g Asia	**82.2**	Top 5 to dev'g Asia	**81.9**	68.7
Top 10 to dev'g Asia	**97.7**	Top 10 to dev'g Asia	**102.5**	Top 10 to dev'g Asia	**97.8**	Top 10 to dev'g Asia	**90.9**	Top 10 to dev'g Asia	**92.5**	75.6

Source: UNCTAD secretariat computations based on UNCTAD FDI/TNC database and World Bank online data.

Notes: *Bermuda, Cayman Islands and Virgin Islands (British) are not included in computations of Latin America and the Caribbean.
** Hong Kong (China) and Singapore are not included in computations of developing Asia.

All the countries in table 4.5 have large natural resource endowments. Indeed, with the discovery of new oil fields in Chad and Equatorial Guinea, all top 10 recipients of FDI in Africa in 2003 have large mineral and petroleum reserves. Consequently, FDI flows to Africa are very heavily concentrated, with the top 10 recipients consistently accounting for three-quarters or more of the total FDI inflows to the continent.

**** SADC countries that fared well with regard to esource-seeking FDI are South Africa, Botswana, Namibia, Zambia and Tanzania.***

4.6.2.2 MARKET ACCESS

Market size is also a key prerequisite for market-seeking TNCs. However, this does not mean a big domestic market. TNCs are mainly attracted by big and growing regional markets. Botswana and Namibia each has a small domestic market. Nevertheless, they are attracting a huge amount of FDI because they have free access to a very big regional market by being members of the SADC. Similarly, the joining of South Africa into the SADC increased the region's attractiveness as an FDI location. A high growth rate market is also very important for TNCs whose home markets are saturated.

Since countries in the SADC region are generally small, regionalism becomes key if the countries are looking to exercise market-size advantage. Regionalism is also particularly important for SADC in terms of population and income. For example, the World Bank (Asiedu, 2003, p. 15) affirms that 15 out of the 48 countries in SSA have a population of less than two million, and about half of the countries have a population of less than six million. Half of the SSA countries have a GDP of less than $3 billion per annum. The total GDP of Sub-Saharan Africa in 2000 was $372

billion, which was about equal to the GDP of Mexico and about one-half the GDP of Brazil.
When South Africa is excluded, SSA's GDP falls to about $201 billion (i.e. about a quarter of the GDP of Brazil and about one half of the GDP of Mexico).

Thus, due to the small size of African countries (both in terms of income and population), a regional bloc such as the SADC is important in order to achieve a market size that will be large enough to attract foreign investors.
**** SADC country that fared well with regards to market-access is South Africa but regional bloc as a whole fares well.***

4.6.2.3 EFFICIENCY SEEKING

Efficiency seeking TNCs seek to operate in host countries that are well organised and competently run. An efficient communication system is a key factor for TNCs to efficiently operate far-flung subsidiaries in the rest of the world, as well as the home office. Subsidiaries need to be able, on a day-to-day basis, to send and receive faxes, e-mails, and make telephone calls. They also need proper transportation links both within the country, and to the outside world. All this may seem obvious, however a dysfunctional telecommunications system in a country can cause an investor to regret his initial choice to locate there.

Qualified labour is another major attractive advantage from a TNCs viewpoint. Cheap labour was playing a determinant role in the 1960s and 1970s, when most TNCs were following a vertical outsourcing strategy. Today, all the firms interviewed, whatever their home country or

industrial sector, stressed that the availability of qualified manpower (particularly for middle-ranking and senior technical positions) is a major consideration.

The results suggest that human capital has a positive impact on FDI. Furthermore, the seminal work of Borenzstein, et al. (1998) indicates that "FDI promotes growth only when the stock of human capital in the host country exceeds a minimum threshold." These two results suggest that in order to attract more FDI and also benefit from the growth-enhancing effect of FDI, SADC needs to educate its population. This is important because illiteracy is very prevalent in the continent.

**** SADC countries that fared well with regards to Efficiency Seeking are South Africa Botswana and Namibia.***

4.6.3 CONGRUENCY

It is therefore not surprising that the SADC host countries that received high scores in both Policy and Business Facilitation, generally attracted more FDI. More importantly there seems to be evidence that suggests that a high policy rating alone or a high business Facilitation rating alone will not lead to foreign direct investment. By extension, a country rich in natural resources but which has inhospitable policies and business facilities, will indeed struggle to attract FDI. It is however worth mentioning that resource rich countries that have natural resources that are high in demand (such as oil and perhaps gold) may still attract FDI depending on how high the demand for that resource at that point in time is. Some TNCs will take the risk of investing in unstable host countries, as they may believe the reward would be worth the risk. With all things being equal, TNCs would exhaust all their options by first looking to invest in host countries that have sound socio economic policies and business facilities.

This is good news for the SADC countries that may not have natural resources but have good policies and business facilitation, as they too stand a chance of attracting FDI.

4.7 CONCLUSION

This chapter set out to apply the FDI framework and analyze whether:

The SADC host countries that have welcoming policies attract more FDI stock

Economic Determinants such as Resources, Market Access and Efficiencies attract more FDI stock

The SADC host countries that have implemented business facilitation attract more FDI

There is a level of congruency between the above three.

The analysis of the SADC countries using the FDI framework conclusively verified that for a country to be attractive, a set of prerequisites has to be fulfilled: being political and macroeconomic stability. These are the most important prerequisite for TNCs. Investors in general are deterred by risk; moreover, they need to be able to evaluate their investment return on a medium to long-term period.

As the World Business Environment survey has revealed TNCs want a corruption free regime. TNCs need free trade to maximise economies of scale generated by manufacturing in different parts of the world. TNC want to maximise profit, and one way of maximising profit is by keeping operational costs down. TNCs want to invest in countries where

transaction costs are low, and where hassle cost and red tape are not deterrents.

Countries that have met these requirements are Botswana, Namibia and South Africa. All three countries scored well in Policy, Business Facilitation and Resources, and all three countries fared well with regard to FDI inflow, FDI stock as well as FDI as percentage of GDP. A good infrastructure is vital to TNCs. All three countries have good telecommunication, electricity and water supply.

Malawi and Zimbabwe's performance in Policy, Business Facilitation and Resources were the least inspired. Zimbabwe, in fact, had the worst score across all three determinants. Whilst Malawi managed to attract FDI inflow, it struggled to attract FDI stock and FDI as percentage of GDP. Zimbabwe, on the other hand, struggled across the board. Zimbabwe's disappointing performance is driven by the civil unrest in that country. Zimbabwe suffers from political and macroeconomic instability. Investors are generally deterred by Zimbabwe's unstable and discriminatory legal and regulatory environment. Moreover, poor laws, unjust regulations, and mass nationalisation at the hands of a dictator provide an unwelcome environment for FDI.

This chapter indicated that TNCs are still attracted to Africa's natural resources. As such, this has resulted in an uneven spread of FDI flows across the continent. The 24 countries in Africa classified by the World Bank as oil- and mineral-dependent, have on average accounted for close to three-quarters of annual FDI flows over the past two decades, and, with the exception of Mauritius, Morocco and Uganda, which featured among the top 10 recipients in some years during the period 1999–2003 (UNCTAD, 2003).

Consequently, FDI flows to the SADC countries are very heavily concentrated in countries that are rich in natural resources.

There seems to be evidence that suggests that a high policy rating alone or a high business facilitation rating alone will not lead to Foreign Direct Investment. By extension, a country rich in natural resources but with inhospitable policies and business facilities, will struggle to attract FDI. It is however worth mentioning that resource rich countries that have natural resources that are high in demand, may still attract FDI.

Regionalism is also particularly important for the SADC in terms of population and income. Due to the small size of African countries a regional bloc such as the SADC is important in order to achieve a market size that will be large enough to attract foreign investors. Efficiency Seeking TNCs endeavour to operate in host countries that are well organised and competently run. Qualified labour is another major attractive advantage from a TNC's viewpoint. The results suggest that human capital has a positive impact on FDI. This is a challenge for most SADC countries, as the quality of the education system is not up to standard.

With all things being equal, TNCs would still first examine all their options by looking to invest in host countries that have sound socioeconomic policies and business facilities. This is good news for the SADC countries that may not have natural resources, but have good policies and business facilitation, as they also stand a chance of attracting FDI.

CHAPTER 5: SUMMARY, CONCLUSIONS AND POLICY OPTIONS

5.1 SUMMARY AND CONCLUSION

The past decade has witnessed a dramatic increase in FDI to developing countries. Regrettably, Africa did not benefit from this FDI boom despite its attempts to attract FDI.

Ironically, whilst SSA's percentage share of real global FDI is decreasing year on year, Africa's percentage rate of return on US FDI has been the highest (World Bank, 2000).

There is overwhelming evidence that FDI can affect growth endogenously, as it generates increasing returns on production via externalities and productivity spill-over. The findings of the reviewed literature in chapter 2 also suggest that the direction of causation between FDI and growth may also depend on existing factor endowments and scale effects, suggesting that larger economies are more attractive to FDI than smaller ones.

This study is relevant because one of the main themes of the Millennium Development Goals (MDG) is poverty reduction. The United Nations General Assembly in September 2000, embarked reduce the number of people living on less than a dollar a day by 50% by the year 2015 (Dikhanov, 2005). Achieving this millennium development goal is therefore particularly important for Africa as the continent houses some of the poorest countries in the world. Approximately 48% of Africa's population live on less than one dollar a day (Dikhanov, 2005).

The fast-growing East Asian newly industrialised economies, such the Asian Tigers, have reinforced the credence that attracting FDI is key to bridging the resource gap of low-income countries and avoiding further build-up of debt while directly tackling the causes of poverty.

It is looking increasingly difficult for Africa to finance its long-term development, poverty reduction and other Millennium Development Goals (MDGs), and achieve this by 2015. Attracting Foreign Direct Investment (FDI) has to assume a prominent place in the strategies of economic renewal being advocated by African policy makers at national, regional and international levels. It is apparent that economies which tend to have substantial inward stocks of FDI, tend to have high growth.

The core enabling framework for FDI consists of rules and regulations governing entry and operations of foreign investors, standards for the treatment of foreign affiliates and the functioning of markets. Complementing core FDI policies are policies that affect foreign investors' locational decisions directly or indirectly, by influencing the effectiveness of FDI policies. These include the trade and privatisation policies. These policies are designed to influence the location of FDI. They constitute an important part of the policy framework.

DHCs need to realise that FDI policies are important. FDI will simply not take place where it is forbidden. It is also important for DHCs to understand that changes in FDI policies have an asymmetric impact on the location of FDI. Changes in the direction of greater openness may allow firms to establish themselves in a particular location, but they do not guarantee this. In contrast, changes in the direction of less openness, especially if radical (e.g. nationalisations), will most certainly ensure a reduction in FDI.

Foreign investors assess DHC's investment climate not only in terms of FDI policies per se, but also in terms of macroeconomic and macro-organisational policies.Among the policy measures that can have a direct effect on FDI is DHC's membership in regional integration frameworks, as these can change key economic determinants which are market size and perhaps market growth. Policy coherence, is particularly important for efficiency-seeking FDI as firms integrate their foreign affiliates into international corporate networks.

It is in the context of a greater similarity of investment policies at all levels that business facilitation measures enter the picture. These measures have become important to DHCs competing for FDI, as FDI policies converge towards greater openness. Business facilitation measures have become more sophisticated, and now include after-investment services. After-investment services are important as satisfied investors are the best advertisement of a country's business climate. Financial or fiscal incentives are also used to attract investors, however they can be costly and thus must be used strategically, especially if DHC cannot afford to forfeit the potential revenue.

The determinants of FDI on SADC indicate that large markets, natural resource endowments, good infrastructure, low inflation, an efficient legal system and a good investment framework promote FDI, whereas, high inflation, corruption and political instability have the opposite effect. The results have several important policy implications. Firstly, it suggests that FDI to SADC is not solely determined by some uncontrollable factor, such as natural resource endowments, and that governments can increase FDI flows by streamlining their investment framework, implementing policies that create a stable macroeconomic and political environment, and improving their infrastructure. Another important result is that good

practices namely less corruption and a reliable legal framework, have a positive impact on FDI. Here, multilateral organisations such as the IMF and the World Bank can play an important role in facilitating FDI by establishing and promoting good institutions in the SADC countries. The results also suggest that regional economic cooperation may facilitate FDI to SADC. Regionalism permits countries to coordinate their policies. For example, members of a regional bloc may require all participating countries to curb corruption, implement sound and stable macroeconomic policies, and adopt an "investor friendly" regulatory framework (such as removing restrictions on profit repatriation).

Using the FDI framework it was proven by countries such as Botswana, Namibia and South Africa that good Policy, Business Facilitation and Resources lead to increased FDI inflow, FDI stock as well as FDI as percentage of GDP. On the contrary Zimbabwe struggles across the board to attract FDI. Zimbabwe's disappointing performance is driven by the political and macroeconomic instability.

The SADC countries need to apply the investment framework if they are to improve on the dismal attempts of attracting FDI thus far. A continued failure to attract FDI has a direct impact on economic growth. This leads to a positive continuation as economic growth has a direct impact on poverty alleviation. Failure to alleviate poverty means the SADC will not meet its Millennium Development goals of halving the number of people living on less than $1 a day by 2015. SADC has to consider the policy options that follow if it is to have a chance of achieving its MDG goals.

5.2 FUTURE POLICY OPTIONS

The results indicate that policy changes in the direction of openness, differ in an important way from those in the direction of restriction. Even when extensive, they cannot guarantee their desired results, whereas radically restrictive policies can almost certainly guarantee theirs. Zimbabwe is a case in point for restrictive policies.

Open policies are basically intended to induce FDI, however the inducement may not be taken. This is evidenced by the fact that a total of 205 global policy changes were identified by UNCTAD (2005), Africa accounted for 53 policy changes. Most of the changes included liberalisation, promotional efforts, operational measures and FDI admission. However, the inducement was not to be taken by the TNCs.

Nevertheless, it is important that the SADC host countries continue to encourage TNCs, given that restrictive policies (such as sweeping nationalisations of foreign affiliates) can effectively close the door to FDI (World Investment Report, 1998). SADC host countries must endeavor to implement sound and stable macroeconomic policies, and adopt an "investor friendly" regulatory framework (such as removing restrictions on profit repatriation). Policy change alone is insufficient to attract FDI. Large markets, natural resource endowments, good infrastructure, low inflation, an efficient legal system and a good investment framework promote FDI, whereas, high inflation, corruption and political instability have the opposite effect.

Regionalism is important to the SADC host countries, as it permits countries to coordinate their policies. For example, members of a regional bloc may require all participating countries to curb corruption.

Non-compliant countries may face costly expulsion from membership. The benefits that accrue from regionalism should serve as an incentive for countries to implement "good" policies. Conversely, if one errant country such as Zimbabwe does not heed the call of the SADC it puts the whole region in a bad light. The region may inherit a bad neighborhood status. Another advantage of regionalism is that it expands the size of the market, and therefore makes the region more attractive for FDI (recalling that market size is an important determinant of FDI to the SADC).

SADC host countries must invest in good practices and a reliable legal framework, as this has a positive impact on FDI. They must do so consistently. SADC host countries must also invest in infrastructures such as good telecommunication, electricity, water, hospitals, schools, etc., as this makes doing business in the host country a better proposition. Lastly, as competition for FDI in a globalising economy will increase; SADC countries may need to extend facilitation services to include after-investment services, that is, services rendered to established foreign affiliates regarding day-to-day operational matters. This will ensure that TNC settle in the host economy and continue to re-invest.

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