

**A Dissertation submitted to the Faculty of Human
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Name: Mpho Mosie Mfolwe
University Number: 16527003
Supervisor: Dr. Samuel Kale Ewusi

TOPIC

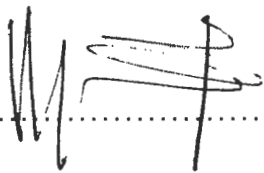
**AN INVESTIGATION INTO THE SOCIO-
ECONOMIC IMPACTS OF FOREIGN DIRECT
INVESTMENTS (fdi) IN AFRICA: A CASE
STUDY OF BOTSWANA**

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DECLARATION

I, Mpho Mosie Mfolwe hereby declare that: the thesis titled: '*An Investigation into the Socio-Economic Impacts of Foreign Direct Investments in African Countries. A Case Study of Botswana*' has not been submitted at this or any other university; that it is my own work in conception and design and that all materials contained herein have been duly acknowledged.

Signature.....
Mpho Mfolwe

DEDICATION

**TO THE SPIRIT OF THE LATE SERAKE ANTHONY YETWA
MFOLWE; FATHER AND ACADEMIC COMPANION WHOSE
UNTIMELY DEPARTURE FROM THIS WORLD DENIED HIM THE
REALISATION OF THIS ACHIEVEMENT, A PATH HE CARVED
WITH GREAT PARENTAL ARTISTRY...**

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ABSTRACT

The main aim of this research was to investigate the socio-economic impacts of Foreign Direct Investments in Africa: A case study of Botswana. Foreign Direct Investments (FDI) in very simplistic terms is defined as the flow of long-term investment resources from foreign residents or firms, into another country with the purpose of having management control.

This research found out that Botswana stands out clearly as a very attractive destination for FDI in Africa due to its relative political stability, favourable tax and foreign exchange policies among others. Moreover, it was established that FDI inflows to Botswana are principally championed by the diamond mining industry and the financial sector. More importantly, the research found out that FDI has had a number of beneficial impacts in Botswana. These include an increase in commercial and trading opportunities throughout the country; innovations in cellular technology and significant benefits in the education, health care and housing sectors among others.

However, the study also found out that in spite of some of the above outlined benefits of FDI, Botswana also bears significant costs resulting from FDI. Some of these include: retardation in

the growth of local economic activities, lack of integration of foreign enterprises into the local economy; inadequate participation of indigenes in the economy of the country among others.

Based on these findings, a number of recommendations were made which include: targeting FDI to needy sectors specifically the manufacturing sector; effective regulatory mechanisms; and moves by the government to alleviate the infrastructure and skill in the country so as to effectively capture knowledge spill-overs from FDI.

CHAPTER ONE

1.1 BACKGROUND

Most African economies have for decades now been plagued by economic hurdles such as unemployment, poverty, high inflation and economic slumps. Moreover, African countries have for many years grappled with building a strong economic foundation for the continent. This has failed despite the continent being endowed with natural resources and a plethora of other resources for economic growth such as uranium, oil, diamonds and foreign markets. This failure is as a result of issues such as underdevelopment, mismanagement of resources, embezzlement of government funds and political instability (Waggon, 2003).

Moreover, after gaining political independence in the 1960s, African countries like most developing nations were very sceptical about the virtues of free trade and investment. Consequently, in the 1970s and 1980s several countries in the region imposed trade restrictions and capital controls as part of a policy of import-substitution industrialization aimed at protecting domestic industries and conserving scarce foreign exchange reserves. There was later substantial evidence that this inward-looking development strategy discouraged trade as well

as Foreign Direct Investments and had harmful effects on economic growth and living conditions in the region. These issues have seen most developing countries being held hostage by a poverty trap, which is having negative consequences on their political, economic and social development (Rodrik, 1998:20).

Against this backdrop, Adebajo and Landsberg (2005) are of the view that, there are calls for Western nations to help relieve African countries of this sad plight. Moreover, Fischer (1998:44) posits that the disappointing economic performance of African countries beginning in the late 1970s up until the mid 1990s, coupled with the globalization of activities in the world economy, has led to a regime shift in favour of outward-looking development strategies. Since the mid-1990s, there has been a relative improvement in economic performance in a number of African countries as a result of the change in policy framework.

In response to this, Western nations have initiated a series of measures to help alleviate the conditions of poor African countries. There are initiatives such as the African Growth and opportunities Act initiated by the United States' government, the Highly Indebted Poor Countries Initiative launched by the G8, and a wide range of North - South and bilateral aid from

countries such as China, France, Britain and Germany. Prominent among these responses to lend a helping hand to developing nations, is Foreign Direct Investments (FDI).

1.1.1 The Issue of Foreign Direct Investments in Africa

Foreign Direct Investments occurs when an investor based in one country (the home country) acquires an asset in another country (the host country) with the intent to manage that asset. The management of the asset is usually conducted from the home country. The investor exerts a significant degree of influence on the management of the enterprise resident in the other economy. Such investment involves both the initial transaction between the two entities and all subsequent transactions between them and among foreign affiliates; both incorporated and unincorporated (Mafusire, 2003).

Until recently, FDI was not fully embraced by African leaders as an essential feature of economic development. This was due to fears that it could among others lead to the loss of political sovereignty, push domestic firms into bankruptcy due to increased competition and, if entry is predominantly in the natural resource sector, accelerate the pace of environmental

degradation. Moss, Ramachandran and Shah (2004:165) argue that much of African scepticism toward foreign investment is rooted in history, ideology, and the politics of the post-independence period.

Nevertheless, FDI is welcomed and actively sought by virtually all African countries today. The contribution that FDI can make to their economic development and integration into the world economy is widely recognized and appreciated. For this reason, African economies have made considerable efforts over the past decade to improve their investment climate. States in their economic reforms have to deal with the creation of a conducive environment for private sector growth and development as well as for the flow of FDIs. They have liberalized their investment regulations and have offered incentives to foreign investors. Such a creation of open markets, friendly to investments and also attractive to investors, becomes elementary to the promulgation of legislative and regulatory tools for FDI entities (Tekere, 2003).

This desire by African governments to facilitate FDI entities is as a result of the benefits that accrue from foreign investments and the role it plays in sustainable development. Most African countries are currently not only targets of FDI, but also partake

in FDI outflows in other countries. The continent has considerably gained grounds on political and economic landscapes making it a better and viable place for international investment. In this light, FDI outflows to Africa are growing. Foreign investors, including from within Africa invested almost 50 billion US dollars in Africa during 2000 – 2003. Some of these countries, which are benefiting from FDI outflows, include South Africa, Tanzania, Mozambique, Uganda and Botswana (Thomsen and House, 2005).

1.1.2 FDI in Botswana

Botswana is a land-locked country that gained independence in 1966 and currently has a population estimated at about 1.6 million people. Four decades of uninterrupted civilian leadership, progressive social policies, and significant capital investment have created one of the most dynamic economies in Africa. Mineral extraction, principally diamond mining, dominates economic activity, though tourism is a growing sector due to the country's conservation practices and extensive nature preserves. Botswana has one of the world's highest known rates of HIV/AIDS infection, but also one of Africa's most progressive and

comprehensive programs for dealing with the disease (CIA World Fact Book, 2006).

During the 1980s, Botswana was suffered from the 'bad-neighbour syndrome'. As a landlocked country, there was considerable threat to the country's peace and stability due to growing insurgencies in Namibia, Angola, and the apartheid hostilities of South Africa. However, in recent times, the country has established good management and economic practices that has built on its reputation as Africa's success story. The government began actively encouraging foreign investment in the mid-1980s. Government policies offered attractive tax rates (10% on corporate income), including a five-year tax holiday and capital grants on new projects. There was also duty-free access to the large South African market which contributes to 80% of Foreign Direct Investments in the country. Botswana also enjoys duty-free access to the European Community for most of its products, as it accounts for 15% of FDI inflows. Its liberal policies allow unrestricted repatriation of earnings and capital (Gale, 2006).

Furthermore, the country has maintained one of the world's highest economic growth rates since independence in 1966.

Through fiscal discipline and sound management, Botswana has transformed itself from one of the poorest countries in the world to a middle-income country with a per capita GDP of \$10,000 in 2005. The country is classified as having the best credit risk in Africa. Diamond mining has fuelled much of the expansion and currently accounts for more than one-third of GDP and for 70-80% of export earnings. Tourism, financial services and cattle rearing are other key sectors. Moreover, the country has a substantial financial assistance policy for foreign investors and has established an export-processing zone in Selebi-Pikwe. Investment law is scrupulously observed by the Botswana bureaucracy and courts. Investment incentives, including cash grants, have been offered to small and medium-scale investors for labour-intensive schemes, particularly outside urban areas (Maipose, 2003).

Moreover, being a landlocked country with a small population, Botswana depends on its neighbours and is an advocate for regional integration and free trade, which are conducive for FDI. The government of Botswana has as its stated objective to encourage direct investment, principally in the mining sector. Against this backdrop, the government has abolished all exchange control, has instituted low corporate tax rates, and

increasingly speeds up the processing of applications for business ventures, leading to a stable macro-economic environment. Moreover, there are no restrictions on capital transactions of foreign exchange accounts and foreign investors have access to credit on the local market. Botswana banks may lend to non-resident controlled companies and other non-resident owned business entities in Botswana without specific approval from the Bank of Botswana (IMF Report, 2006).

Against this backdrop, FDI flows to Botswana are commonplace. Botswana has a long-standing commercial relationship with the DeBeers consortium. This relationship has been in existence since the first diamond exploration was made in Botswana. Other investors include China, whose investments in Botswana are in the form of roads and houses construction and the United States, which invested in the Kalahari Gas Corporation. The United Kingdom and South Africa also contribute to FDI inflows to the country and MNCs like Indicator Minerals, Eurostar Diamond Traders, Standard Bank, Shoprite Checkers are investing across a wide range of sectors spanning from business and financial services, property, tourism, leisure, transport equipment and both heavy and lightweight industries. These investors account

for the total amount of 620 million US dollars of FDI inflows into Botswana (LOCOMonitor, 2005).

1.2 RATIONALE OF STUDY

There is a rapid encroachment of FDI inflows into the economy of Botswana. Foreign investors increasingly have no small role to play in determining the economic situation of the country. Their investments have contributed in opening up the markets of the country and are having impacts on the socio-economic situation of Botswana. The rationale of this study was thus to examine these impacts as positive for the development of the country.

1.3 STATEMENT OF THE PROBLEM

The growing encroachment of globalisation and the opening up of the economy of Botswana to foreign investors, has led to a considerable upsurge in FDI inflows into the country. These FDI inflows which have the potential to bring developments to Botswana's economy span across a myriad of sectors. However, the nature of FDI and its impact on the socio-economic and political have not been empirically studied.

It is against this background that the statement of the problem is addressed in the following questions:

- What is the nature of Foreign Direct Investments in Botswana?
- What are the socio-economic impacts of Foreign Direct Investments in Botswana?

1.4 AIM OF THE STUDY

The main aim of this research was to investigate the socio-economic impacts of Foreign Direct Investments in Botswana.

1.5 OBJECTIVES OF THE STUDY

The objectives of this research are:

- To explore the sectors of FDI in Botswana
- To investigate the socio-economic impacts of FDI in Botswana

1.6 HYPOTHESIS

Foreign Direct Investments seems to enhance socio-economic development of Botswana.

1.7 SIGNIFICANCE OF THE STUDY

The study was of great importance because it reveals opportunities and challenges of a liberal economic regime for the government and the people of Botswana, while identifying potential threats to the nation's socio-economic affairs. Furthermore, the study will usher in new information in its findings for other researchers on the interplay between socio-economic impacts of FDIs and development on domestic market environment. This could be the basis for future research at other areas concerning Botswana in international relations.

Moreover, this work will go a long way in adding value to the existing body of knowledge on Foreign Direct Investments in African countries, and other developing countries as a whole.

1.8 SCOPE OF THE STUDY

This study was limited to the impacts of FDI on the socio-economic situation of Botswana.

1.9 LIMITATIONS OF THE STUDY

This research focuses on Foreign Direct Investments in Botswana. Any study in foreign policy and economic diversification matters is an intrusion into privy areas of government. In view of this, access to information on certain areas was blighted by the inability or unwillingness of respondents to answer sensitive questions.

Furthermore, financial circumstances proved burdensome to some of the objectives of this work. Huge financial costs involved in the collection and analysis of data downplayed on the researcher's ability to effectively explore all sectors concerned. This was however mitigated by in-depth research through accessible sources.

CHAPTER TWO

2.1 LITERATURE REVIEW

It is important to review related literature regarding any research problem. This exercise provides the researcher with an opportunity to evaluate the different theories related to the research problem in order to deepen the theoretical framework to be followed. In this section, the researcher explores and analyzes the different developments in the debate surrounding the socio-economic and political impacts of FDIs. This process helped the researcher to discover the extent of research done on the research problem. The literature review also enables the researcher to identify variables that must come into play if such variables are deemed to do justice to the research problem.

Furthermore, the researcher familiarises himself with varying perspectives from authors in the field of international political economy. There is a broad spectrum of literature on issues in international political economy specifically on FDI. Such texts were instrumental in the compilation of a valuable research work. This activity expanded the researcher's scope in terms of work done on the subject elsewhere.

Much has been written on FDI by economists, scholars and academics in the field of humanities and / or the social sciences. The purpose of this section is not merely to reinvent the wheel through repetitive presentations of available literature, but more importantly to analyze important variables relevant to the topic and to draw a synthesis of the divergent ideas put forward by the various researchers in the field. Against this backdrop, this section overviews concepts and highlights arguments raised by other authors and propound justifications on the impacts of FDI on the socio-economic and political development of states in general, and Botswana in particular.

2.1.1 Defining Foreign Direct Investments

Foreign Direct Investments is defined as the flow of long-term investment resources from foreign residents or firms, into another country with the purpose of having management control. It involves a long-term relationship and reflects 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 direct investor. FDI is not only a transfer of ownership from domestic to foreign residents but also a mechanism that makes it possible for foreign investors to

exercise management and control over host country firms—that is, it is a corporate governance mechanism. The transfer of control may not always benefit the host country because of the circumstances under which it occurs, problems of adverse selection, or excessive leverage (Mafusire, 2003).

FDI is engaged by transnational corporations (TNC's). Broadly defined, a TNC is a firm which has the power to coordinate and control operations in more than one country, even if it does not own them (Dicken, 1998: 8). This definition refers to the TNC's power to extend its control over legally independent firms through its web of collaborative relationships. In addition to that, TNC's are able to take advantage of the geographical difference including natural endowments and policies in a particular country, and move their operations between various geographical scales. In practice, TNC's are firms having operations in at least two countries including the firm's home country. There are about 61,000 TNC's with over 900,000 foreign affiliates in the world (UNCTAD, 2004: xvii).

One striking feature of FDI flows is that their share in total inflows is higher in riskier countries, with risk measured either by countries' credit ratings for sovereign (government) debt or by

other indicators of country risk. There is also some evidence that its share is higher in countries where the quality of institutions is lower. These paradoxical findings can be explained by the fact that FDI is more likely, than other forms of capital flows, to take place in countries with missing or inefficient markets. In such settings, foreign investors will prefer to operate directly instead of relying on local financial markets, suppliers, or legal arrangements. The policy implications of this view are that countries trying to expand their access to international capital markets should concentrate on developing credible enforcement mechanisms instead of trying to get more FDI (Albuquerque, 2000).

Although some FDI promotion efforts are probably motivated by temporary macro-economic problems such as low growth rates and rising unemployment, there are also more fundamental explanations for the increasing emphasis on investment promotion in recent years. In particular, it appears that the globalization and regionalization of the international economy have made FDI incentives more interesting and important for national governments. Trade liberalization, be it globally, through the World Trade Organisation or regionally, in the form of the European Union, the Southern African Customs' Union and other regional agreements, has led to increasing market

integration and reduced the importance of market size as a determinant of investment location (Blomström and Kokko, 2003:2).

Added to the above, the challenge of utilizing FDI as part of the development process is much more complicated than conventional wisdom suggests. The decision to invest by a business entity requires due diligence in calculating the prospects that emanate from the particular investment. However, the host government is also pressed in considering best practice to allow a friendly investor environment, which usually means foregoing some pillars of economic decision making for the government. The direct and indirect benefits from well-constructed FDI projects are substantially greater than commonly assumed, but they do not come easily. In this context, evidence suggests that horse-trading visits both the potential investor and the potential host government (Moran, 1998:153).

2.1.2 The Growth of Foreign Direct Investments in Africa

FDI is one of the indicators of the increasing interdependence of economies in global terms. Since the mid 1980s, the world economy has been experiencing rapid increase in FDI flows, even

faster than the world trade or output. For example, over the period 1993 - 2000, the global FDI increased six-fold. FDI has a general upward trend and the expansion of international production is likely to continue in the future, although at a slower pace. Changes in the world economy and the rapid increase of FDI, especially during the 1990s, have led to significant revisions in investment regimes in most countries that earlier had maintained restrictions on and control of FDI. Numerous countries are nowadays facing pressure to pursue liberal investment policies. They have started to relax legislative restrictions on inward investment and on other aspects of transnational corporation activities (UNCTAD, 2003:26, 85-86).

Following the mal-performance of the Bretton Woods institutions particularly in Africa, the feasibility of trade with Africa had become doubtful. African states pursued restricted trade policies and regional trade became their preferred avenue, as a measure of security to sovereignty and political independence. For many developing countries, attracting FDI as part of the development strategy has become the only game around. In this assertion, countries have given up their protective economic regimes, and now embrace more open and liberal options to economic diversification (Grunberg, 2001:347).

According to Tambunan (2004), developing countries in Asia, Africa and Latin America have come increasingly to see Foreign Direct Investments as a source of economic development, modernization, income growth, employment, and poverty reduction. This is reflected by their currently pursued economic policies, which is explicitly intended to improve conditions to attract FDI and to maximize the benefits of the presence of FDI in their domestic economy. Over the past two decades these countries have implemented broad ranging economic reforms, including the liberalization of their foreign trade and investment regimes and domestic markets and privatization of state companies, which have had an effect on the flow and nature of foreign investment.

Many African governments have recovered or are still recovering from high debts that were a result of post-independence nation building and structural adjustment programs of the IMF and the World Bank. Following this, governments of Africa have assumed a much deliberate approach in ending the protectionist legislation on internal economics and trade resulting in more open markets, capitalistic investments, free trade and international investments. As such, the same governments have

accelerated their quest for free trade and have naturally restructured internal policies and legislature, therefore creating and providing lucrative investment incentives and opportunities for foreign companies, usually multinational or transnational companies. In their approach to business investment in developing countries, the MNCs do not relocate by closing down business in their home countries. They however purchase domestic resident's controlling stake in a foreign company. This is basically a foreign investment which Razin (2002:1) refers to as an extension of corporate control over international boundaries. Conceptually, this is the mode of existence of Foreign Direct Investments and it forms a central definition of the concept without departing from other areas of domestic investment by international businesses.

FDI patterns reveal that there is a stronger preference in the manufacturing and services sectors, but there is also a presence of FDI flows to developing countries and least developed countries in natural resource sectors. These developing countries often lack the economic diversification to provide opportunities for investors in other areas. Investment in natural resources has traditionally exploited limited regulatory regimes, which are

often suspect to corruption and poor governance due to high economic rents derived from the sector (Gray, 2002).

2.1.3 Benefits of Foreign Direct Investments

There has been apparent change in attitude from critical wariness towards multinational corporations to enthusiasm about the effect of FDI in the development processes of African developing countries. Investment promotion has become a pre-occupation of contemporary policy framework for most African states, and this has become central to creating investment-friendly environments for host-countries aspiring to attract international investors. Kebonang (2004:12) is of the opinion that FDI can be opportunistic vehicles to lift Africa's hopes and objectives of promoting sustainable development and poverty. The continent has suffered setbacks dating to the pre-colonial era. Following the wave of independence that swept across the continent in the 1960s, there was an upsurge of internal fights, civil wars, intra and interstate conflicts, growing despondency, autocratic rule and other strong afflictions on the people of the continent.

From the point of view of host developing countries, certain important benefits can be highlighted. These include the transfer of technology to individual firms and technological spill over to the wider market; increased productive efficiency due to competition from multinational subsidiaries; improvement in the quality of the factors of production including management in other firms and not just the host firm; benefits to the balance of payments through the inflow of investment funds; increases in exports; increases in savings and investment, and hence faster growth of output and employment. Consumers may benefit both from lower prices of goods and the introduction of new or better quality goods (UNCTAD Report, 2006).

Economists tend to favour the free flow of capital across national borders because it allows capital to seek out the highest rate of return. Unrestricted capital flows may also offer several other advantages, as noted by Feldstein (2000). First, international flows of capital reduce the risk faced by owners of capital by allowing them to diversify their lending and investment. Second, the global integration of capital markets can contribute to the spread of best practices in corporate governance, accounting rules, and legal traditions, and third, the global mobility of capital limits the ability of governments to pursue bad policies.

Furthermore, FDI allows the transfer of technology, particularly in the form of new varieties of capital inputs that cannot be achieved through financial investments or trade in goods and services. It can also promote competition in the domestic input market. Moreover, recipients of FDI often gain employee training in the course of operating the new businesses, which contributes to human capital development in the host country and the profits generated by FDI contribute to corporate tax revenues in the host country. FDI is unequivocally good for development as long as the investors do not pollute the environment or blatantly abuse workers. Against this backdrop, the more FDI the host country can attract, the better (Loungani, and Razin, 2001).

It is widely believed that, given the appropriate host-country policies and a basic level of development, benefits that might accrue from FDI include employment creation, the acquisition of new technology and knowledge, human capital development through employee training in new business ventures (for example multinational relocating), contribution to international trade integration, creation of a more competitive business environment and enhanced local/domestic enterprise development, flows of ideas and global best practice standards aiding international

competitiveness and increased tax revenues from corporate profits generated by FDI.

All of these forms of benefits are expected thus to contribute to higher economic and employment growth, which is the most important/effective tool for achieving improvements in human well being or alleviating poverty in developing countries (Tambunan, 2004).

Another important channel through which FDI can have a great contribution to economic growth in developing countries is by supporting export growth of these countries. FDI is an important engine for export growth in developing countries. It is a key factor driving export-led growth especially in sectors such as electronics. Besides their contributions through joint ventures, foreign firms can serve as catalysts for other domestic exporters. In an empirical analysis, the probability that a domestic plant will export was found to be positively correlated with proximity to multinational firms.

Governments may encourage potential exporters to locate near each other by creating special economic zones or export processing zones, duty free import of inputs, subsidized

infrastructure, or tax holidays, to help reduce costs for domestic firms in breaking into foreign markets. The fact that FDI has positive effects on export growth in developing countries is simply because it may provide access to new overseas markets. It may also serve to improve efficiency and productivity, as well as increasing competition in the host country (Cotton and Ramachandran, 2001).

Moreover, Razin (2002:2) submits that FDI flows play an important role in the process of skimming high productivity investment projects and contributes significantly to domestic investments in both the quantity and the quality dimensions. The character and effect of FDI is essentially a critical determinant of development in any host country, which culminates in good effect on socio-political and economic aspects of the host country.

FDI is seen as a panacea for economic development, bringing in necessary technology, expertise and financial resources to developing economies. These countries often do not have the capacity to take advantage of liberalized trade and open markets and are unable to produce items for export. The entry of a new firm in a non-tradable sector increases domestic investment,

increases industrial output, and may thereby reduce the domestic price, leading to a net improvement in welfare.

FDI is vital for the development of individual countries and global development. A prominent discourse for international investors is the core nature of comparative advantage as a theoretical justification for international trade.

Comparative advantage provides a basis for explaining and justifying international trade in an economic model assumed to enjoy free trade; perfect competition, no uncertainty, costless information and no government interference in international trade, opportunities for investment in one country are realised upon an evolution of existing environments.

International trade players have their own 'conducive' environments in which they will invest. Such an environment has to be characterised by free trade and other imperfections in national markets. The imperfections translate into market opportunities such as: economies of scale, managerial or technological expertise, financial strength and product differentiation (Jadalla, 2001:15).

More so, in the face of inadequate resources to finance long-term development in Africa, and with poverty reduction and other Millennium Development Goals looking increasingly difficult to achieve by 2015, attracting FDI has assumed a prominent place in the strategies of economic renewal. This being advocated by policy makers at the national, regional and international levels. There is a strong belief that attracting FDI is the key to bridging the resource gap of low-income countries and avoiding further build-up of debt while directly tackling the causes of poverty (Prosad et al, 2003).

2.1.4 Drawbacks of FDI

Despite the above-mentioned benefits of FDI, there is some suspicion concerning the contribution of FDI to domestic environments. This uncertainty results from the costs involved in FDI inflows. Among these acknowledged costs are the possible negative effects on the balance of payments due, for example, to an increase in the import of inputs by subsidiaries and to payments of dividends and royalties abroad.

Moreover, to the extent that multinationals exercise considerable market power, not only do the direct cost of non-competitive

pricing have to be considered, but it is also necessary to take into account the overall inefficiency in the allocation of resources to which such pricing behaviour leads. In view of the large absolute size of many multinationals, the question of their impact on the competitive environment also becomes critical (UNCTAD, 2006).

According to Razin et al. (1999), FDI may not necessarily benefit the host country. Through FDI, foreign investors gain crucial inside information about the productivity of the firms under their control. This gives them an informational advantage over uninformed domestic savers, whose buying of shares in domestic firms does not entail control. Taking advantage of this superior information, foreign direct investors will tend to retain high-productivity firms under their ownership and control and sell low-productivity firms to the uninformed savers. As with other adverse-selection problems of this kind, this process may lead to overinvestment by foreign direct investors.

Furthermore, Grunberg (2001:346) is of the opinion that FDIs are channelled through highly visible organizations, with great power and mobility. Because of this, they inspire both awe and fear. Although FDI may have wider technological benefits, through spill over effects, it could also discourage the

development of technical know-how by and in local firms and institutions, to the detriment of the growth of domestic producers and the national economy. If it fails to generate adequate linkages with the local economy, FDI will have fewer beneficial spill-over effects and may have social costs in the form of unemployment, when FDI, which is relatively capital intensive, causes the more labour intensive local firms to close down, resulting in a net loss of jobs.

Moreover, increasing FDI flows may have worrying impacts for a host country's ecosystems and social development. Investors may seek countries that have a less strict, or non-existent regulatory regime. This is termed the 'pollution haven theory'. A correlative to this is that host countries may attempt to exempt or loosen their regulatory requirements in order to attract investment. The competition for FDI may create a 'race to the bottom' of environmental, labour and other standards (Gray, 2002).

Also, an open market in FDI in the print media and in the entertainment fields also pose the risk of facilitating hegemony by the dominant United States and other western cultures, rather than providing a window on a multicultural world, something

which is also a matter of public concern in parts of the North. This is especially a problem in societies in the South where the funds for local production are scarce or non-existent.

FDI in the news and entertainment sector thus may facilitate subtle and widespread political influence, both through the world-view that is conveyed in the form of propaganda, and by the attitudes adopted toward domestic issues and matters on the political agenda. Sometimes, and even more importantly, politico-strategic interests are at stake, as when FDI comprises a large component of total investment and involves loss of control over strategic sectors of the economy, vital infrastructure, and natural resources.

Moreover, decisions made principally abroad may have a considerable impact on the local economy and society and, directly or less directly, on socio-economic polity. In some circumstances, even the country's sovereignty may be at stake (OECD Report, 2006:11).

2.2 THEORETICAL FRAMEWORK

This section is important because it is a body of accumulated scholarship. It thus provides information on how other scholars have theorized and conceptualized on the concept of FDI. Also, it elucidates how this phenomenon impacts on the relations between states in the international polity. Thus, in this section, the most recent, credible and relevant theories on the role of hegemony in international politics are overviewed. The theoretical framework thus sets the basis and provides meaningful context within the framework of already existing research. This section aims to uncover a theoretical model that recognises both the relevant FDI internal and external factors having socio-economic and political impacts on the environments of Botswana.

2.2.1 Liberal Economic Theory

Being one of the main theories of international political economy, the liberal economic theory was propagated by leading nineteenth century economist, Adam Smith. It evolved in modern times through economist John Keynes in the 1930s. Economic liberals argue that the market economy is an autonomous sphere of society, which operates according to its own economic laws. Economic exchange is a positive sum game and the market will

tend to maximise benefits for the rational, self-seeking individuals, the households, and the companies that participate in market exchange. The economy is a sphere of cooperation for mutual benefits among states as well as among individuals. The international economy should thus be based on free trade. While classical liberal economists view the role of the state as that of leaving the market alone, including international as well as national markets, some twentieth century liberals propose improved political management of the market (Jackson and Sorenson, 2003:183).

The liberal economic theory is of great importance to this study. The Botswana government has been striving to put into place all the necessary things that would allow the country to have a comparative advantage in attraction of Foreign Direct Investments. Two of the main policies have been low direct taxes and a subsidy scheme under the Financial Assistance Policy. A free market regulated by the government is operational in Botswana. The country is a target for a wide range of FDI inflows. Principally championed by diamond mining which accounts for about 75% of export earnings, other sectors of investment include the banking sector and other forms of service delivery such as Nandos and Shoprite-Checkers, all totalling an amount of

620 million US dollars in FDI inflows. Botswana has a substantial financial assistance policy for foreign investors; it has instituted low corporate tax rates, it allows unrestricted repatriation of earnings and capital to MNCs; and Botswana banks may lend to non-resident controlled companies and other non-resident owned business entities in Botswana without specific approval from the Bank of Botswana (IMF Report, 2006).

2.2.2 Dependency Theory

The dependency school theory views foreign investment from the developed countries at the core of the world economic system as harmful to the long-term economic growth of developing nations out in the periphery. It considers that the penetration of peripheral economies by large companies allows them to control resources that might otherwise have been used for national development. It asserts that First World nations become wealthy by extracting labour and material resources from the Third World. This kind of capitalism perpetuates a global division of labour that causes distortion, hinders growth, and increases income inequality in developing economies. Dependency theorists argue that developing countries are inadequately

compensated for their natural resources and are thereby sentenced to conditions of continuing poverty (Xiaoqin, 2002:2).

Despite the postulation of a liberal economy by certain scholars, dependency theorists are of the opinion that FDI has overall long term damage to local economies. Due to its liberal economic policies, the country is plagued by capital flight, underdevelopment and poverty. Foreign investors such as Anglo Gold, Standard Bank and DeBeers benefit significantly from the economy of Botswana. With over 80% of its GDP being accounted for by foreign investors (the DeBeers Mining Company, Shoprite Checkers and South African banks), the sustainability and stability of the country will be questionable in the absence of these investment initiatives. According to a South African Broadcasting Corporation Report (2006), any country that has more than 5 % of its GDP in the form of FDI, will or has suffer(ed) from financial crisis within a period of 5 years.

CHAPTER THREE

DELINEATION OF VARIABLES

3.1 INTRODUCTION

As highlighted in the aim of the study, this research sought out to analyze the impacts of Foreign Direct Investments on the socio-economic development of Botswana. However, it is necessary to examine literature pertaining to other African countries on the impacts on Foreign Direct Investments on their socio-economic development. In executing this task, certain questions will be addressed. These include:

- What instruments have been put in place by African countries to attract Foreign Direct Investments?
- What is the nature and extent of Foreign Direct Investments in these countries?
- What are the socio-economic and political impacts of Foreign Direct Investments in Africa?

Measuring the effects of Foreign Direct Investments (FDI) on economic growth occupies a substantial body of economic literature. Moreover, the vast literature on Foreign Direct Investments (FDI) has been suffering from a lack of comparative

work based on specific case studies drawn from different regions of the Africa. Many theoretical and empirical studies have identified several channels through which FDI may positively or negatively affect economic growth. However, probably due to relatively small level of Foreign Direct Investments to Africa, when compared with other regions, e.g. Latin America and Asia, not many studies have been reported on the effects of FDI on socio-economic development. Moreover, most existing studies were based on economies where large share of FDI is concentrated on the manufacturing industries. This section attempts to fill this gap (Akinlo, 2004).

3.2 ATTRACTING FOREIGN DIRECT INVESTMENTS IN AFRICA

Following the mal-performance of the Bretton Woods institutions particularly in Africa, the feasibility of trade with Africa had become doubtful. African states pursued restricted trade policies and regional trade became their preferred avenue, as a measure of security to sovereignty and political independence. For many developing countries, attracting FDI as part of the development strategy has become the only game around. In this assertion, countries have given up their protective economic regimes,

initiate incentives and now embrace more open and liberal options to economic diversification (Grunberg, 2001:347).

Incentives can be described as policies used to attract internationally mobile investors. Through the Export Processing Zones (EPZ) programme, African countries offer incentives to attract foreign investment in the form of tax holidays, exemptions on export and import duties, investment and reinvestment allowances, loan and loan guarantees, greater protection for intellectual property rights subsidized infrastructures, and limits on workers rights. Opinions about the importance of incentives vary significantly. Governments consider them as a means to obtain FDI whereas transnational corporations perceive EPZs as providers of favourable investment sites (CUTS, 2001 and Jauch, 2002).

Furthermore, African countries have improved their regulatory frameworks for FDI by opening their economies, permitting profit repatriation and providing tax and other incentives to attract investment. Improvements in the regulatory framework for FDI have been stressed in many countries through the conclusion of international agreements on FDI. Most African countries have concluded bilateral investment treaties with

countries whose main aim is the protection and promotion of FDI. They also clarify the terms under which FDI can enter the host country (UNCTAD, 1999:6).

Morisset (2000:1-3) contends that for many observers, the capacity of African countries to attract Foreign Direct Investments (FDI) is principally determined by their natural resources and the size of their local markets. Although there have been a considerable number of analytical and empirical studies on FDI inflows, there has also been a limited consensus on which factors play an unambiguous role in explaining the location decision of TNC's. It is generally accepted that market size and access to natural resources are crucial determinants in their decision processes. Over the years, Nigeria has been one of the most successful countries because of its comparative location advantage in oil despite its unstable political and economic environments.

According to Morisset (2000) however, abundance in natural resources and a large local market do also play an influential role in attracting FDIs. Alluding to the successful and well-known experiences of countries such as Ireland and Singapore, he suggests that Sub-Saharan African countries can also generate

the interests of international investors by improving their business climates. While highlighting the fact that establishing a competitive business climate is a difficult task because it takes time —not only to implement policies but also to convince potential investors, he suggests that for most African countries that do not even feature on the radar screen of most companies, the implementation of a few visible actions is essential in the strategy of attracting FDI.

On the other hand, an UNCTAD press release (2006) maintains that at the other extreme, FDI inflows remained below US\$100 million in 34 African countries. These are mostly least developed countries (LDCs), including oil-producing Angola, which witnessed a drastic decline in FDI receipts in 2005. Many of the low FDI recipients in the region have limited natural resources; lack the capacity to engage in significant manufacturing, and, as a result, are among the least integrated into the global production system. Some countries have also experienced political instability or civil war, which destroyed much of their already limited production capacity in the recent past.

Assessing the trend of FDI inflow into Africa has also been a major preoccupation of some analysts. According to Thomsen

(2005), private capital flows to Africa in the form of Foreign Direct Investments (FDI) are growing. He claims that while in the past much of this investment was limited to the raw materials sector, the current wave involves firms from more countries and sectors than ever before. This increase, he claims, is at least partly a response to improvements in governance and their impact on overall economic performance, and partly as a result of external events over which African countries have little control.

Tanzania typifies the sub-Saharan experience. It is among the poorest countries in the world, with its agricultural sector accounting for nearly 50% of GDP, 85% of export earnings, and 80% of the labour force. MNCs have little incentive to involve themselves in economies like these. Despite cheap labour and agricultural production capacities ripe for improvement, MNCs and poor African economies have few mutual interests. A company makes a mistake if cheap labour is the primary motive that leads it to invest in a particular country, unless the company involved intends the investment to be of relatively short term and the investment itself does not involve much fixed capital. Furthermore, the agricultural sector at present offers limited opportunities for FDI. These are primarily in relatively low-tech

areas, such as the production and processing of traditional commodities, fruits, poultry, and dairy products. In terms of generating new agricultural technologies for Africa, the only incentive for investment has been the formidable mineral endowment of the region (Dampier, 2006).

Equally interesting is Asiedu's (2005) analysis which attempts an analysis of the ingredients that make for a good investment climate. She argues that besides an endowment with natural resources and a large local market, FDIs can also be attracted by Sub-Saharan countries that make efforts to improve their institution and policy environment. In other words, lower inflation rates, good infrastructure, an educated population, openness to FDI, less corruption, political stability and a reliable legal system are all needed to build a business climate acceptable to foreign direct investors.

An unstable political climate on the other hand discourages foreign direct investors. A case in point is Zimbabwe. In 1998, Foreign Direct Investments (FDI) in the country totalled over 444 million US dollars. By 2001 however, FDI in-flow had fallen to 5.4 million US dollars. This could be attributed to a couple of factors among which are: the lack of foreign currency in the country

making investment even less attractive because of the near-impossibility of converting earnings out of the rapidly depreciating local currency, which the government in any cases restricts; the suspension of IMF funding, which had negative implications about the credit-worthiness of the country, and contributed in limiting most business transactions to a cash basis; and a rejection of a gradualist approach to the land restitution campaign by the government resulting in over 4000 white-owned farms being taken against the will of the owners. These have had serious political and economic implications for the Mugabe regime in particular, and for FDI in the country as a whole (National Encyclopaedia, 2003).

Asiedu's (ibid) argument puts her at loggerheads with Amuwo (2006) who retorts that good governance as promoted by international financial institutions and the donor community has been reduced to nothing more than trade liberalization, currency devaluation, subsidy withdrawal from agriculture, privatization of commanding heights of the economy, and transforming the private sector as the engine of development. The end result of which is an economic administration that gives priority to nominal economic growth above the greatest welfare for the greatest number of people.

Despite the fact that South Africa is ranked among Africa's top ten recipients of FDIs, some analysts have however expressed concern about the low rates of foreign investments made in the country, compared to those in other emerging countries like Brazil and China. According to Harvard Business School Professor Erik Werker (2006), despite enormous economic reforms, and an enduring political stability, the country has still failed to attract FDIs as one would have expected, thereby debunking standard views of how Foreign Direct Investments works. This he attributes primarily to the very strength of the corporate climate in South Africa, which makes it difficult for foreign firms to penetrate, and other issues such as the high rates of crime and HIV/AIDS prevalence.

An UNCTAD report (2006) challenges this view by stipulating that South Africa was the largest FDI recipient in the region in 2005. The country experienced a sharp jump in FDI inflows to US\$6.4 billion from only US\$0.8 billion in 2004. South Africa accounted for about 21% of the region's total. This was mainly due to the acquisition of Amalgamated Bank of South Africa by Barclays Bank (United Kingdom) for US\$5.5 billion. Africa's top ten recipient countries - South Africa, Egypt, Nigeria, Morocco,

Sudan, Equatorial Guinea, the Democratic Republic of Congo, Algeria, Tunisia and Chad, in that order - accounted for close to 86% of the regional FDI total (figure 2). In eight of these countries, FDI inflows exceeded US\$1 billion (more than US\$3 billion for Egypt, Nigeria and South Africa in particular). Inflows to South Africa were also the most diversified: investment was channelled into energy, machinery and mining, as well as into banking, which received the largest share.

3.3 BENEFITS OF FDI IN AFRICAN COUNTRIES

According to Mwilima (2003:31), Foreign Direct Investments is viewed as a major stimulus to economic growth in developing countries. It is perceived as having the ability to deal with major obstacles such as shortages of financial resources, technology, and skills. This has made it the centre of attention for policy makers in developing countries such as Africa. FDI refers to investment made to acquire a lasting management interest (usually at least 10 % of voting stock) and acquiring at least 10% of equity share in an enterprise operating in a country other than the home country of the investor. FDI can take the form of either

“Greenfield” investment (also called “mortar and brick” investment) or merger and acquisition (M & A), depending on whether the investment involves mainly newly created assets or just a transfer from local to foreign firms. According to him, there are five main anticipated benefits of FDI. These include:

- FDI is seen as an important source of capital formation particularly when the capital base is low. Capital inflow is seen as a way of creating a surplus in the capital account of the balance of payments or to make up for the deficit on the current account.
- Transfer of technologies is expected because foreign companies will use technology from their home country. From a developmental perspective, it is more important that technology is diffused with spill- over into the local production process, and that technology be adopted and adapted by local enterprises. For an economy to improve on quality, technological upgrading is crucial. Technical inefficiency, in developing countries, can severely hinder the quality of products produced and the ability to cope with new demands.
- It is argued that FDI will lead to employment creation.

- Transfer of management skills, to local managers, takes place when investors set up new plants, acquire companies or outsource to local subcontractors
- FDI lead to increased export competitiveness.

The story of investment in the sugar sector in Mozambique for instance, shows some of the benefits that Foreign Direct Investments can deliver, and particularly how the right government policy can ensure that these benefits go directly to poor people. The sector has attracted US\$350 million in investment, mainly from South African and Mauritian companies. Currently there are more than 20,000 people directly employed in the sugar mills, with wages guaranteed by the government's minimum wage policy. The impact on the local economies from increased demand for goods and services has been striking. This is particularly important, as sugar factories tend to be located in rural areas, which have suffered the most from weak markets and lack of business opportunities. Mozambique also earns nearly US\$30 million a year from sugar exports (Benn, 2006).

In the same vein, Johnson (2005) argues that knowledge capital is a characteristic of MNEs and that technology is a component of knowledge capital. The MNE is assumed to possess a technology

that is superior to the technology available to host country firms. However, elements of that technology can voluntarily or involuntarily spill over, allowing host country firms to adopt the MNE technology. Technology spillovers provide the strongest potential for FDI to enhance economic growth. Foreign MNEs have a technology advantage over domestic firms and MNE entry in the form of FDI results in a positive externality in the form of technology spillover from the MNE to domestic firms. The domestic firms are thereby able to improve their level of technology and become more productive.

An example of FDI with wide-ranging positive spin-offs has been the South African automotive sector. Owing largely to a favourable operating climate, the sector has attracted large FDI inflows in recent years. The nature of value chain dynamics in this sector and involvement of mainly European holding companies has led to the integration through strong trade and technology linkages of the local sector into the global industry. At a time when the global automotive sector was shrinking by 3.9%, the South African automotive sector in fact grew by 13, 9%. While the sector is one of South Africa's largest and sustains some 300,000 jobs, it has nevertheless shed a substantial number of jobs over the previous decade as domestic economic

policies shifted away from import substitution and manufacturers were forced to become globally competitive (IISD, 2004).

Moreover, FDI can have numerous developmental spin-offs. FDI opportunities necessarily present themselves as being attractive and potentially profitable - despite the local availability of capital - when local resources and opportunities are taken together with a third dimension, namely foreign skills and technology. Typically, FDI involves far more than the mere inflow of capital; investors in most cases take an active role in the local operations, introducing skilled personnel from the home country, introducing foreign technology not available locally and expanding trade linkages with the home country as well as third countries. A bi-product of FDI is usually also the introduction of new technology, as investors introduce proven technology from the source entity to the host country. An example of this relates to the proposed aluminium smelter in South Africa, to be situated in the Coega IDZ, where French-Canadian company *Pechiney* plans to introduce the latest AP50 smelting technology with its associated raw materials and energy efficiency, as well as its vast output capacity (Coega Development Corporation, 2003).

In the political domain, Asiedu's (2005) analysis touches on the highly debatable theme of good governance, and true to its neo-liberal undertone, it pays homage to the already distrustful technocratic/economic notion of good governance by buying into the idea that multilateral organizations such as the IMF and the World Bank are central to the promotion of good institutions in Sub-Saharan African countries that want to attract FDIs.

3.4 DRAWBACKS OF FDI IN AFRICA

According to UNCTAD (2005) up to 80 per cent of total FDI to Africa is going into extractive sectors and, owing to their capital-intensive nature, has not generated all of the desired benefits. In this regard, it has underscored the need to encourage greater productive direct investment, including foreign investment, in African countries to support their development activities and to enhance the benefits they can derive from such investments. Moreover, opening up the mining industry, for instance, to foreign providers without restriction or control first of all brings in unfair competition to domestic mining ventures. Small scale mining, for example, will be opened up to foreign interest and with no limitation on profit use and repatriation, the proceeds

made by foreign companies will not be reinvested into the economy as already evidenced by large scale mining companies.

The case of Namibia is instructive in this regard. In 1995, Namibia passed its EPZ Act. Four years later, LaRRI carried a study to assess the socio-economic impact of Namibia's EPZ programme. This study revealed that Namibia had come short of the expectation in terms of the EPZ programme. The government anticipated creating 25 000 jobs by the end of 1999. The actual number of jobs created at the time of the study was 400. The study carried out by LaRRI unravelled poor labour conditions that could lead to future conflicts. This prediction was confirmed in 2002-2003 when RAMATEX, a Chinese owned textile company producing for the US market from Namibia had two strikes within months of each other. The reasons were poor working conditions and poor salaries, typical conditions that prevail in EPZs (Mwilima, 2003).

Similarly, Ghana's Mining Code of 1986 was acclaimed as the most liberal mining code in Africa at the time as part of attempts to encourage FDI in the sector. Indeed, the Ghanaian model set the pace for liberalization of the mining sector in other mineral endowed states in Africa such as Mali and Tanzania. In Ghana,

these reforms led to very stringent ramification of the regulations of the mining sector, primary of which was the withdrawal of the state from the mining industry to facilitate privatization. The reforms also formed the basis for providing generous incentives for investors, which included substantial tax breaks, generous subsidies and other corporate welfare strategies that subverted economic benefits for the nation. Discernibly, although there was increased investment in the mining sector in Ghana, the country has yet to experience the portent benefits of such investments. A calculation based on 2003 Government of Ghana figures of the total value of mineral exports juxtaposed with income revenue derived from mineral taxes illustrates that Ghana earned only about 5 per cent of the total value of exports; this amounts to approximately \$46.7 million out of a total profit of \$893.6 million realized from mining.

Moreover, Obwona and Mutambi (2004) argue that in principle, there is no direct link between Foreign Direct Investments in Africa and poverty reduction. FDI may result in significant poverty reduction effects, if a number of other prerequisites are in place. If not, the FDI effects may be zero or even negative. They further argue that FDI spillovers depend on the host

country's capability to absorb the foreign technology, and on the type of investment climate in the host country. The higher the level of available human capital in a country and the better the investment climate, the stronger the spillover effects will be.

In the same vein, Addison and Mavrotas (2004) add that, FDI can contribute to the Millennium Development Goals by reducing income-poverty (through its employment effect) and, via its revenue effects, as a source of finance for public spending on human development, particularly in the areas of basic health care, primary education and safety nets for the poor. However, they argue, these potentially strong development benefits of FDIs can only be realized if the host country has a clear vision of how FDI fits into its overall development strategy. By implication, FDI is a useful, but not a miracle, ingredient for development.

Against this backdrop, caution has to be taken as far as privatizing certain sectors of the economy is concerned. This is because MNCs are primarily profit-driven and thus investments in service delivery sectors for instance might lead to negative effects on the populace. For example, new research from South Africa shows that recent water privatizations involving two multinationals – UK-based Biwater and French-based Suez – are

having a disastrous impact on the rights of poor people. Price hikes and disconnections have hit poor families and many vulnerable people have lost access to adequate water supplies. Ensuring access to affordable basic services like water and sanitation for poor people, however, is crucial for poverty reduction and experience shows that the logic of the profit motive that underpins liberalised water delivery has reduced access to water for many poor communities worldwide (Wijeratna, 2005).

This view can be supported by the fact that reforms and the growth spurt have yet to have an impact on poverty. According to the FDI Magazine (2005) for all its lingering problems, Africa is growing economically and attracting larger amounts of FDI. In spite of this, poverty is still rampant, with close to half the population living on less than \$1 a day. If the Millennium Development Goals - which call for a reduction of extreme poverty by half by the year 2015 - are to be achieved, the continent needs to grow by about 7% for many years.

Moreover, Research conducted by UNCTAD (2002) revealed that, for the host country, the benefits of mergers and acquisitions are lower and the risks of negative effects are greater when

compared to Greenfield investments, especially at the time of entry over the short term. An UNCTAD (2005) research on mergers and acquisitions concluded that:

- FDI through mergers and acquisitions do not generate employment at the time of entry into the host economy, and may lead to lay-offs as the acquired firm is restructured,
- FDI through mergers and acquisitions can reduce competition, and may be used deliberately to reduce or eliminate competition; and
- Over the longer term, cross-border merger and acquisition are often followed by sequential investment that does increase the capital stock.

3.5 CHAPTER SUMMARY

Erixon (2005) posits that African countries are poorer today than they were at the time of their independence from colonial powers. In spite of more than US\$1 trillion in aid to Africa over the last 50 years, the big push in development has yet to occur. If the idea of aid had been true - in particular the alleged link between aid, investment, and growth - many of those countries

would today have eradicated extreme poverty and have a GDP per capita similar to that of New Zealand, Spain or Portugal. If nothing else, aid and FDI to Africa seems to have lowered rather than increased economic growth. It is sound economic policies, not aid, that in the last decades have lifted millions - even billions - of Asians out of extreme poverty, and provided the resources to limit the extent of (or in some countries, eradicate) starvation, diseases, and other visible signs of poverty. Moreover, if FDI is not channelled towards investment in the manufacturing sectors and sound economic policies, no significant positive impacts will be realized, as the data presented shows that extractive FDI especially in the extractive sectors might not be growth enhancing as much as FDI in the manufacturing sectors.

FDI brings both costs and benefits that must be properly evaluated when deciding on the best policy approach to adopt. Evaluating net gains will be country and sector specific, with policies towards FDI tailored accordingly and in full knowledge that there will be trade-offs and potentially conflicting interests between multinationals and host governments. Recent developments particularly in the mining sector, suggests that policy makers in Africa should give more careful consideration to

these trade-offs if they wish to maximize the benefits from FDI (UNCTAD Report, 2005:65).

CHAPTER FOUR

METHODOLOGY

4.1 INTRODUCTION

The Case Study research method was used. This research investigated the socio-economic and political impacts of Foreign Direct Investments in African countries and a case study of Botswana formed the core of this research. Creswell (1998) defines a case study as an exploration of a “bounded system” or a case (or multiple cases) over time through detailed, in-depth data collection involving multiple sources of information rich in context. According to Creswell, the bounded system is bounded by time and place, and it is the case being studied – a program, an event, an activity, or individuals. The data collection was extensive, drawing on multiple sources of information such as observations, documents, and audio-visual materials.

Moreover, case studies have their strength in the ability to focus on the subject under study. More importantly, by using a variety of data collection techniques and methods, a case study can produce a more rounded, holistic study than any other design. In other words, the use of multiple sources of evidence, which is characteristic of case studies, makes the case study one of the

most powerful research designs. Hence, the choice of the design for this study entailed a descriptive, exploratory and illustrative analysis of the impacts of Foreign Direct Investments on socio-economic development Botswana.

Tellis (1997) maintains that a case study is an ideal methodology when a holistic, in-depth investigation is needed since these are exploratory, explanatory and descriptive. According to Yin (1984: 23), this research method is an empirical inquiry that investigates a contemporary phenomenon within its real-life context when the boundaries between phenomenon and context are not clearly evident; and in which multiple sources of evidence are used.

4.2 METHOD OF DATA COLLECTION

As indicated above, a major strength of the case study design is rooted in its ability to produce a more rounded, holistic study using a pool of primary and secondary sources of information. The researcher maximized this advantage by collecting data from as many sources as possible. Data was collected both from

primary and secondary sources. Primary sources, which consist mainly of interviews, of data provided firsthand information of the problem under study. This approach is a traditional method used by social scientists in extracting information through well-placed individuals in institutions and in the society. It is part of the ethnographic approach, often used in situations where access to official records or data is weak or non-existent. In this case, where official records existed, it was used as a means to gain further insight by questioning key people about specific social, political and economic problems. Sources of information included:

- A review of government policies and legislature;
- Documents and literature materials from conferences, workshops, summits and seminars on subjects of foreign trade and Foreign Direct Investments;
- Analyses of reports published by organizations monitoring the trend of FDI in Africa;
- Review of internet journals and books;

It is worth mentioning that information collected primarily from secondary sources, which sometimes suffer from lack of clarity and specificity, can be biased and thus turns out to be more or

less unreliable. This setback in secondary data was addressed by corroborating secondary sources with primary sources. Against this backdrop, the researcher conducted semi-structured in-depth interviews with officials of the Botswana government, informants and other stakeholders and experts in international economic issues, as well as scholars and other researchers whose insight was ideal to the objectives of this work.

4.3 METHOD OF DATA ANALYSIS

This study entailed analysis of historical events, conditions or progressions; deductive reasoning based on the facts of evidence, and assessment of qualitative data. Thus, the researcher made use of specific events, sets of circumstances, over a period of time to introduce and/or exemplify the theoretical and conceptual frameworks developed in chapter two and the researcher's own judgment, to establish a correlation between theory and fact.

Moreover, the entire data analysis process was grounded on the constant comparative method. Thorne (2000) argues that this

analytical strategy provides the base for more descriptive, interpretive and thematic analyses that develop ways of understanding human phenomena within the context in which they occur. Thus, this research involved comparing segments of data within and between categories in order to develop conceptualizations of possible relations between various pieces of data.

4.4 ETHICAL CONSIDERATIONS

The researcher obtained a letter of introduction from the Supervisor at the North-West University (Mafikeng Campus) to the subjects of study. Appointments with the key persons for interview were scheduled. The letter served the purpose of enabling the key persons to understand the purpose of the study and, to therefore, facilitate the acquisition of information by the researcher. Furthermore, due care and diligence was exercised in dealing with the respondents; this enabled the researcher to gain their confidence thus increasing the quality of the responses.

Moreover, given the fact that data was collected through both primary and secondary sources, the main ethical issues taken

into consideration here was confidentiality and anonymity in respondents and acknowledgement in the publication of results. The researcher avoided all forms of research misconduct, fabrication, falsification, or plagiarism, including misrepresentation of credentials, in proposing, performing, or reviewing research, or in reporting research. The researcher also pointed out the limitations of the findings and acknowledged all assistance, collaboration of others, or sources from which information was borrowed.

Given this backdrop, the following ethical procedures were observed in this research:

- The respondents were informed, beforehand, that participation in the study was voluntary, and information received was for pure academic purposes
- The researcher ensured confidentiality of information and anonymity of the names of respondents, especially as some of the subjects were active in government services and were involved in the process of policy making on a daily basis.
- The position, political inclination and official views as well as opinions of the subjects regarding issues raised in the study were respected.

- The researcher provided research reports to the institutions and persons interviewed for them to ensure that their views were not misrepresented.
- The researcher endeavoured to achieve a balance of academic inclination vis a vis political dispensation, and national position on economic matters.

CHAPTER FIVE

PRESENTATION OF FINDINGS

5.1 NATURE AND EXTENT OF FOREIGN DIRECT INVESTMENTS IN BOTSWANA

As both a vector and a product of globalisation, FDI is now a critical factor driving world growth. Countries in the developing world are competitive in their approach and recruitment of international investors; similarly, emerging economies have become targets for international investments. In seeking growth opportunities for technology and skills transfer, stronger exports, prosperity and high employment levels, the government of Botswana is keen on attracting capital investment to boost local economic growth.

The investment by a multinational corporation (MNC) in any country apart from the home country is Foreign Direct Investments; hence Foreign Direct Investments is by the MNCs. The main objective of MNCs, like any other business venture, is to maximise profit and to reduce cost. Therefore consideration is given to regions which are likely to bring highest returns on investments and enabling environment for business to succeed. This provides one of the main reasons why there are more FDI in

some places than others. According to Sethi et al. (2003), MNC investments will be higher in regions that provide the best mix of the traditional FDI determinants.

Botswana stands out clearly as a very attractive destination for FDI. The country has a shining example of political and economic stability on the African continent, with its A-grade credit ratings, well-educated workforce, growing financial sector, mineral wealth, strong export focus and was classified by Transparency International as the least corrupt country in Africa in 2005. Botswana offers stability, a good reputation for corporate governance and a credit rating that places it alongside many developed countries. Its economy has a proven track record and, with foreign exchange controls abolished, its investment environment is strong. Consequently, the country is proving an interesting proposition to foreign investors in tourism, finance, information communications technology (ICT), manufacturing and mining (Atkins, 2005).

According to a Botswana Business Forecast Report (2005), the business environment is one of the most attractive in Africa, propped up by political stability, low levels of corruption and sound regulatory frameworks. A liberal tax and foreign exchange

regime are further pluses on Botswana's business environment score sheet. Importantly, the domestic private sector remains relatively feeble, and as a consequence the government has actively sought to stimulate Foreign Direct Investments (FDI). But the shallowness of the domestic consumer market is a constraint, as is a shortage of qualified labour and a still relatively unwieldy bureaucracy. The burden of the latter is likely to diminish going forward, as evidenced in pro-active drives to facilitate FDI.

An IMF Report (2006), projects that FDI inflows to Botswana are principally championed by the diamond mining industry and the financial sectors, with the former accounting for about 75% of all export earnings. Other sectors of investment are principally championed by South African multinationals and include Standard and First National Banks in the financial sector, Pick 'n Pay, Shoprite, and Nandos among others, in the retailing and service delivery sectors (clothing and textile - manufacturing sector is almost inexistent). These corporations constitute a total sum of 620 million US dollars in FDI inflows to Botswana.

According to a Nations Encyclopaedia Report (2006), the retail and wholesale trade sector accounted for 9.1% of FDI inflow in

1999 and manufacturing, 3.1%. The British Commonwealth Development Corporation has invested in a Lobatse slaughterhouse and in three large cattle ranches, two in the northern part of the country and one on the Molopo River in the Kalahari. H. J. Heinz (South Africa) owns 80% of Kgalagadi Soap Industries, with assets of over \$5 million. Houston-based brick manufacturer, Interkiln Corp., has a 17.5% interest in the Lobatse Clay Works. Owens-Corning owns 50% of a plant producing fibre glass piping for water transportation, in conjunction with the BDC. Other areas of investment include specialty agricultural production; construction; and manufacturing of textile, health and beauty, agricultural and construction equipment products. The government seeks investments in infrastructure, telecommunications, tourism, and housing development.

5.2 IMPACTS OF FDI IN BOTSWANA

In recent years, policymakers, especially in the developing countries, have come to the conclusion that Foreign Direct Investments (FDI) is needed to boost growth in their economies. It is claimed that FDI can create employment, increase technological development in the host country and improve the economic condition of the country in general. In most African

countries, inadequate resource to finance long-term investment is a major problem. This lack of investible funds is a big setback to economic growth and this is making it increasingly difficult to achieve the Millennium Development Goals (MDGs) by 2015 as set by the United Nations. Foreign Direct Investments is seen as a major source of getting the required funds for investments, hence most African countries offer incentives to encourage FDI, Botswana being no exception (United Nations, 2005: 2).

In a contradictory view, Townsend (2003) holds that the relationship between Foreign Direct Investments and economic growth is not so clear. There are different views by researchers on the contributions of FDI to economic growth, based on theoretical and analytical findings. Some see FDI as a very important tool for economic growth especially in the developing countries but some scholars claim that the contribution of FDI to economic development is not as pronounced as most people believe. Yet some scholars think FDI has no positive contribution to the economic growth of the host country. There has been no consensus opinion on FDI and economic growth. Lall (2002) concludes that the contribution of FDI to economic growth depends on many factors and it varies over time and from one host country to another.

5.2.1 Benefits of FDI on Socio-Economic Development of Botswana

MNEs have the financial strength to invest in large plants. This might be very difficult for local investors due to their lack of huge investment funds which MNEs can afford. Through FDI, 'scarce' capital can be made available to the developing countries. This is very crucial to economic growth. According to Alfaro (2003), in addition to the direct capital financing it supplies, FDI can serve as a source of valuable technology and know-how to the host developing countries by fostering linkages with local firms. These technological innovations by MNEs play a central role in the economy and they are some of the most important areas where MNEs serve as catalyst to growth in developing countries.

Against this backdrop, innovations in telecommunication and the proliferation of cellular technology have led to an increase in commercial and trading opportunities throughout Botswana. The telecommunication infrastructure features a healthy level of competition and comprises one fixed and two mobile operators. This competition has in turn resulted in a reduction in call

tariffs. In 2003, Botswana recorded about 300,000 subscribers, far exceeding expectations. Today, this figure has grown to roughly 500,000. According to an interviewee, communications have improved to such an extent that individuals can have e-mail and internet transactions at even the most remote parts of the country (FDI Magazine publication, 2005).

Furthermore, according to the Sunday Standard (2007), there is little doubt that over the years Kgalagadi Breweries Limited (KBL) has contributed handsomely to the economic growth of Botswana. Other than huge sums of money they pay as tax revenues to the national treasury, the company has also been one of the foremost corporate entities that have observed and implemented a generous corporate social responsibility regime. Through that Trust, the group has disseminated millions of Pula's to some of the worthiest community projects across the country, especially in the rural areas of Botswana. In the recent past, the group has started a very commendable project, "Kick-Start", which aims to give young people a helping hand in as far as starting businesses through availing of training and seed capital. The brewer's holding company, Sechaba, has floated limited amounts of shares on the Botswana Stock Exchange thereby contributing not only to the growth of Botswana's capital

markets, but also giving Batswana a rare opportunity to buy into what is, without doubt, one of the country's most profitable blue chip operations.

Moreover, in a bid to enhance economic growth and sustainable development in Botswana, Insurance brokers, Aon Botswana, announced that they had entered into a deal in which they will transfer 25 percent of their shares, worth 25 million Pula's, to local shareholder CEDA Venture Capital Fund. This move aimed at boosting citizen participation in the firm now puts 30 percent of the company shareholding into the hands of local citizens as employees of Aon already hold five percent in the company, which they acquired in 2004, thus empowering the Batswana economically (Mmegi, 2007).

In addition, the Botswana government and DeBeers, the world diamond cartel, have aggressively argued that diamonds in Botswana have been the basis for the country's astounding annual economic growth of 7 percent per year in real terms since independence in 1966. Representatives of the government and DeBeers have pointed out that in contrast to other resource rich countries; Botswana has used its huge income from diamonds to provide some of the best education, health care and housing

programs in Africa for its 1.8 million citizens. Holm (2007) attempts an appraisal of the positive impacts of the country's diamonds on social development. He holds that free public education is provided to all children up to age 13, after which only a minimum tuition is required. Government health facilities are distributed across the country, and these facilities are close to providing antiretroviral therapy to one-hundred thousand citizens infected with HIV and in need of treatment for AIDS. Five thousand miles of paved and well maintained roads allow travellers to move effortlessly between major population centres. Government almost totally finances the education of 12,000 students to study at the University of Botswana, providing room, board and a small allowance. Another 7,000 young people study overseas on full public scholarships.

5.2.2 Drawbacks of FDI in Botswana

Despite the benefits that can be derived from FDI, it should be noted that it can also bring about some negative impacts. For instance, activities of MNCs can displace local firms that cannot cope with the competition from foreign firms, thereby reducing the growth of the local firms (Jones, 1996). Also, if proper regulation is not in place in the host country, FDI can serve as a

source of capital flight from the developing countries to the developed ones. For instance, due to some specific risks in the host country (economic and political risks); there could be large flows of capital from the host country to the home country if there is no legislation against such practice. This can have adverse effect on the host economy especially if such capital is sourced from within the host country. Finally, due to MNCs' higher production capacity, FDI can cause large scale environmental damage which sometimes is not well taken care of especially in the mining sector (Bora 2002).

Mwlima (2003) also does not see FDI as an important tool for development. He claims that the incentives and tax holiday adopted by most African countries to attract foreign investment have not been successful; instead it is adding to the economic problems of some of the countries. According to him, most African countries are competing to attract FDI to the level that each country wants to give the best incentives. This sometimes leads to the situation where the incentives could be more than the gain from the foreign investment. This can leave the country worse off than it was before the investment.

It is worth mentioning that a country cannot attain sustainable economic development through foreign aid. According to Holm (2007), there is an even more pessimistic side to the story of Botswana's development. To put the matter simply, diamonds have produced distorted development. Most obvious has been the limited economic spin-off in terms of employment. Debswana, the diamond mining corporation owned jointly by the government and DeBeers, employs about 6,500 people, or just 2 percent of the workforce. To be sure, there is significant secondary employment generated by the company's contractors and consumption by Debswana employees. The bottom line, however, is that after decades of rapid GDP growth, about 40 percent of the working age population is unemployed. Apart from the diamond industry, no other economic sector has experienced much growth.

Moreover, in spite of the positive role played by the Kgalagadi Breweries on the social development of the country, there are some major shortcomings which, in effect, have reduced these otherwise positive contributions to tokenism. Effectively, the management contract precludes Botswana citizens from holding positions of power and influence inside KBL. Under this contract, the influential positions of Group Managing Director, Operations

Director and Finance Director can only be held by representatives of SAB or SABMiller. Citizens are also excluded from even heading the smaller operation of Botswana Breweries Limited, a wing of KBL, which produces traditional beer. Such policies raised questions as to what extent Batswana are involved in the economy of their own country (Sunday Standard, 2007).

More so, FDI in Botswana has contributed in retarding the growth of local economic activities. This appears to have been most prevalent in the retail sector, where South African chains such as *Pep* (clothing) and *Shoprite* (food) are now located in most cities in the region. For example in Maun, a small yet rapidly expanding frontier town serving mainly the tourism industry in north-western Botswana, more than 5 major South African retail chains have established a presence in the past few years, and their dominance has made it impossible for local players to play a meaningful role in the clothing, furniture or food sector. The situation is exacerbated by a lack of integration of these enterprises into the local economy, instead choosing to source most of their supplies from South Africa. This has lead to accusations across Africa of South African firms being the new economic ‘colonialists’, and calls for a regional investment policy (IISD, 2004).

5.3 CONCLUSION

Due to the many socio-economic problems facing African countries, most have become desperate in trying to find solutions. The problems vary from high unemployment rates, poverty, and lack of technology. In their efforts to overcome these problems, most African countries have taken advice from bodies such as the International Monetary Fund and the World Bank to liberalize their economies in order to attract FDI which in turn, they believe, will bring development. The liberalization of economies have led to African countries engaging in privatisation, introducing incentives to attract FDI in the form of tax holidays, relaxing regulatory framework, and introducing investment promotion agencies responsible for attracting FDI. This has led to countries engaging in a 'race to the bottom', offering investors more and more attractive financial incentives, and reducing the regulatory requirements on firms. Engaging in this type of competition almost inevitably means that even the country that 'wins' (the investment) has paid too high a prize for it (Mwilima, 2003).

Tandon (2002) indicates that there is no real evidence that FDIs bring development, just as there is no evidence that liberalization, in general brings development. It is important to keep in mind that FDI is not in business for development, but to make profit, whereas governments are supposed to ensure development. The fact that the goals of both government and investors are not the same, does indicate that it becomes a very difficult task to direct FDI in a way that will lead to development.

However, Alfaro (2003) is of the opinion that the contribution of FDI to growth depends on the sector of the economy where the FDI operates. He claims that FDI inflow to the manufacturing sector has a positive effect on growth whereas FDI inflow to the primary sector tends to have a negative effect on growth. For the service sector, the effect of FDI inflow is not so clear. However, an economy with a well-developed financial sector gains more from FDI.

To draw a synthesis between these views however, Ugandan President Museveni as cited by Ngwane (2003) pinpoints that, 'aid has never developed a single African country to a stage of social transformation.' Developed nations are more interested in exploitation, personal interest and self gain rather than uplifting

African economies through Foreign Direct Investments or any form of aid. The dependency theory remains relevant as it helps us understand the egocentricity of investment. A UNDP Report (2003:155) shows that in 2000, the European Union's (EU) annual aid to sub-Saharan Africa amounted to \$8 per African person while EU's annual daily subsidy to EU cows was \$913 per cow. Given this statistics, Ngwane (2003:23) sarcastically maintains that one would rather be a cow in Europe than a human in Africa. Given this scenario, it can be safely concluded that there is no altruism in FDI.

5.4 RECOMMENDATIONS

Based on the presentation of findings, the following recommendations are made:

The Government of Botswana should exercise caution when opening its doors to foreign direct investors. In the process of attracting FDI, the government should assess the kind of development the country needs, thus targeting FDI accordingly. It should then set up policies which will guide the developmental process of the country. FDI must only be allowed to operate under effective observatory mechanisms based on certain nationally determined conditions and must conform to certain

performance requirements that will ensure a positive impact on development.

Furthermore, the government of Botswana should still leave its doors cautiously open to foreign direct investors. This is because it cannot be whole fully concluded that FDI is not beneficial to socio-economic development since some impacts of FDI in the country cannot be measured quantitatively, e.g. knowledge acquisition, technology and international image, and it may take a considerable time before these variables affect growth.

In addition, the country has to initiate a move away from promoting Foreign Direct Investments in the primary sector, to a drive towards encouraging FDI in the manufacturing sector. Moreover, a lot has to be done to alleviate the infrastructure and skill in the country. If there is no proper infrastructure, foreign direct investors have to build their own in order to produce, transport, sell or export their products. Infrastructure and skills help to absorb the positive effects from FDI. While the provision of good quality and appropriate basic education is important, attention should also be focused on high-level specialized training in technical subjects to meet the needs of MNCs. With a more skilled workforce and a better infrastructure (ports, roads

water pipelines, electricity and telecommunications), local firms can more easily capture knowledge spillovers, for instance through becoming local suppliers (te Velde, 2002:7).

Moreover, there are a number of ways governments can ensure that FDI contributes to social development. A solid environmental management regime is an important prerequisite. An environmental impact assessment process should help screen out or re-work potentially or already damaging investments. There should be clear regulations governing emissions and managing exhaustible resources such as fisheries and forestry, as well as the capacity to enforce those laws. A state-of-environment reporting system should help monitor environmental trends to pick up any unexpected impacts (IISD, 2002).

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APPENDIX 1: QUESTIONNAIRE

Dear respondent,

I am a Master's student in the Faculty of Human and Social Sciences, department of Peace Studies and International Relations in the North West University, Mafikeng campus.

I am currently doing a research project on 'the impacts of Foreign Direct Investments on the socio-economic development of Botswana.' This study is purely for academic purposes and thus, the identities of respondents will remain anonymous if they so desire, so as to maintain confidentiality in the presentation of findings.

QUESTIONNAIRE

Please be as explicit and specific as possible

1. Outline some multinational corporations involved in Foreign Direct Investments in Botswana.

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.....
.....

2. Identify some projects in which these multinationals are involved in the country?

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.....
.....

3. How beneficial / unbeneficial are these projects to the socio-economic development of the country? Elaborate.

.....
.....
.....

4. Do you think Foreign Direct Investments is a catalyst to social upliftment and economic growth in Botswana? Illustrate

.....
.....
.....

5. Can you pinpoint any specific drawbacks of multinational corporations to the socio-economic development of Botswana?

.....
.....
.....

6. How should Foreign Direct Investments be tailored so as to ensure maximum socio-economic development?

.....
.....
.....