

**THE RELATIONSHIP BETWEEN FINANCIAL CRISIS
AND FOREIGN DIRECT INVESTMENT:
A STUDY OF THE 2007-2009 FINANCIAL CRISIS
AND ITS IMPACT ON FDI INFLOWS TO
MOZAMBIQUE AND TANZANIA**

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Abstract

This paper explores the impact of the recent financial crisis on inflows of foreign direct investment to Mozambique and Tanzania, two countries that share markedly similar economic qualities, yet performed drastically different in their abilities to attract foreign direct investment during the financial crisis. It looks at key indicators that serve as determinants of foreign direct investment disbursement, and finds that the adherence to these determinants can allow a country to realize growth in inflows of foreign direct investment despite an economic climate that would portend otherwise. It finds that government policy, rather than uncontrollable variables such as natural resource endowment, can be a successful driver for attracting foreign direct investment. Based on the analysis of the research and findings, the paper offers conclusions that augment the relatively young discourse on the impact of the financial crisis on the developing world.

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Introduction

The subprime mortgage crisis that began in the United States in the last quarter of 2007 and gradually engulfed the financial markets throughout the developed world during the following year also spread to the developing world, affecting the budgets and financial solvency of seemingly remote economies in sub-Saharan Africa (SSA). By 2008, the World Bank had downgraded its forecast for growth in developing African countries, largely based on the belief that investment and lending capacity of developed economies would be curbed by the sudden shortfall of capital (Massa and Velde, 2008: 2).

To be sure, there was initial optimism that many countries in the developing world, especially in Africa – where poverty is especially rife – would be spared from the abatement of financial resources brought about in integrated market economies (Arieff et al., 2010: 2). After all, the continent had enjoyed increasing growth rates and foreign direct investment (FDI) inflows among and into its countries. Before the onset of the global financial crisis, SSA enjoyed considerable gains in foreign direct investment. Net FDI had peaked by 2007, at \$33 billion, up from \$13 billion three years before (Macias and Massa 2009: 1). Total FDI, counting the value of both the inflow to Africa and its countercurrent, realized \$1.8 trillion in 2007, comfortably surpassing previous totals (UNCTAD, 2009a: 1). Even after the onset of the sub-prime mortgage crisis in the autumn of 2007, FDI continued to pour into SSA during the first quarter of 2008 (Jones and Ocampo 2009: 5).

Yet as 2008 drew to a close, many African countries were beginning to acknowledge the troubling impact the now global financial crises could have on the continent; as Kenyan Prime

Minister Raila Odinga said in early October of that year, “They say that when America sneezes, Europe catches cold, Asia develops pneumonia and Africa’s tuberculosis gets worse. This is what we are beginning to see” (Holmqvist, 2008: 18). Indeed, it was becoming quite clear that even Africa’s most underdeveloped and distal economies would be affected by the financial crisis (which began, ironically enough, from the gluttonous behavior within the U.S. housing market).

Had the crisis remained a U.S. affliction, its affect on SSA may have been negligible. In fact, the underdevelopment of Africa’s financial sector may have served as a bulwark against the financial crisis, sparing the region from the institutional collapse that consumed the developed world (Boorman and Christensen 2010: 70). Indeed, the impact of the financial crisis has shown to be greater in more developed – though still emerging – economies (especially in Central and Eastern Europe) than in low-income countries throughout SSA, largely because the latter are far less integrated into international financial markets (Jones and Ocampo 2009: 6).

Understandably, the countries that were (and remain) positioned to suffer significantly from any reductions on FDI inflows are the world’s developing countries, especially those classified as “least developed countries” (LDCs), the vast majority of which are found in sub-Saharan Africa.¹ Included within this group are Mozambique and Tanzania, which, despite their underdevelopment, were shining examples of the growth potential of poverty-ridden African states during the 1990s and early years of this century. Mozambique and Tanzania have both

¹ “Least developed country” is a classification defined by the United Nations, using a criteria that take into consideration gross national income per capita, nutrition, health, education, literacy, and economic vulnerability (which includes such indicators as population size, remoteness, agriculture, and homelessness). For a complete definition, see (UNOHRLLS, 2010) at: <http://www.unohrlls.org/en/ldc/related/59/>

seen their economies grow by a yearly average of roughly 8 percent during the last decade, making them two of the best performing African economies in the LDC world, and in all of Africa if one excludes the petroleum producers (Clement and Peiris, 2010: 359; Lu and Marco, 2010: 99).

With the onset of the financial crisis, however, growth across the continent was crippled. Tanzania's forecasted 2009 GDP growth rate was downgraded by the World Bank, from 8 percent to 5 percent, and the government estimated a \$255 million loss in domestic income (Lunogelo et al., 2010:1). Mozambique's GDP growth rate also slowed between 2008 and 2009, from 6.8 percent in 2008 to an estimated 6.5 percent in 2009, down from an anticipated 7 percent (Castel-Branco and Ossemane, 2010: 1). Although the growth rate in both countries declined, there was a conspicuously sharper decline in the growth rate of Tanzania. Moreover, and more importantly for the purposes of this study, evidence suggests that while Tanzania's share of foreign direct investment inflow decreased in 2009, along with most of the rest of the continent, Mozambique actually experienced an increase in FDI inflows during the same year, despite having a remarkably similar economic makeup to Tanzania (Bank of Mozambique, 2009).

Chapter 1: Background and Research Design

1.1 Case Selection

Mozambique and Tanzania serve as the case selections for this study for a few important reasons. First, they share comparable economic portfolios, with both countries dependent foremost on agriculture, and then on mineral deposits and manufacturing sectors, and, importantly, devoid of appreciable natural gas and petroleum reserves, all of which allows for a complementary juxtaposition of exogenous shocks (such as the financial crisis) and inflows (such as FDI) to their economies (CIA World Fact Book, 2010). Second, both countries are statistically similar with regard to important economic measuring sticks, namely nominal GDP per capita, which for 2008 totaled \$520 for Tanzania and \$477 for Mozambique (ranking them 34 and 36 out of all African countries, respectively) (IMF, 2009). Additionally, for the purposes of this study, their similar shares of FDI inflows to Africa prior to the onset of the financial crisis (\$600 million for Tanzania against \$427 million for Mozambique, in 2007) place both proximately within the middle range for the continent, and place both at a relative starting point from which to analyze divergence as the crisis progressed (UNCTAD, 2009). Table 1, below, illustrates several comparable and important economic indicators between the two countries.

Table 1 Key economic indicators comparison for Tanzania and Mozambique

<i>Country</i>	<i>Nominal GDP per capita (USD)</i>	<i>GDP Growth Rate (USD; 2009 est.)</i>	<i>FDI Inflows, 2007 (USD millions)</i>
Tanzania	520	4.9	600
Mozambique	477	4.3	427

Data Sources: "Nominal GDP": (IMF, 2009); "GDP Growth": (CIA, 2010); "FDI Inflows": (UNCTAD, 2009)

1.2 Research objectives

This study seeks to augment the existing literature on the impact of the financial crisis on sub-Saharan Africa, with the understanding that the canon of literature on this topic is in its infancy. This study has three main objectives: first, to contribute to growing body of literature on the subject of the impact of the financial crisis on FDI to the African continent, thereby contributing to the understanding of how such an economic environment influences capital flows; second, to place Mozambique and Tanzania within the existing conception of FDI inflow determinants, discussing the similarities of their economies and methods each has employed to attract FDI; third, to examine how the financial crisis has affected FDI inflows to Mozambique and Tanzania following the onset of the financial crisis, and discuss how and why these two seemingly similar economies have experienced such different trends in their FDI inflows and development, which has thus far favored the (slightly) smaller and more benighted Mozambique over its larger

neighbor. The research will conclude by examining future policy implications for each country with regard to FDI disbursement attraction, considering the current direction of both.

1.3 Problem statement and research question

The data and observations mentioned in the section on case selection, while suggesting a similarity between the economic conditions prevalent in each country, baldly appears to favor Tanzania, showing it to have both a slightly higher nominal GDP per capita and a modestly larger share of African FDI inflows than Mozambique. Yet, as mentioned, Mozambique has enjoyed considerably more favorable conditions during the financial crisis, with a lower reduction to its growth rate than Tanzania and some suggestions that FDI may not have contracted at all, while in it's northern neighbor it certainly has.

Considering this, the research and discussion of this study is aimed at answering the following research question: How can we explain Mozambique's superior performance in attracting and retaining FDI inflows during the financial crisis than Tanzania?

1.4 Methodology

This paper entails a qualitative research methodology, undertaking a comparative analysis in order to shed light on the public policy debate regarding the relationship between FDI and developing countries within a climate of global financial crisis. In doing so, it will rely primarily on secondary data, such as academic articles and official data from international organizations

such as the IMF and OECD. In addition, the research consults several primary sources that illustrate historic trends in FDI flow to augment the understanding of and appreciation for the current trajectories of FDI flows in each country. The paper will conceptualize FDI and discuss the determinants of its disbursement, providing qualitative indicators in order to understand two seemingly similar economies (that of Tanzania and Mozambique) could experience such divergent patterns in FDI inflows during an economic crisis that, generally, placed both countries within the same exogenous economic climate.

1.5 Limitations

This study, like all others focused on conceptualizing how the financial crisis affected the developing world, is limited by the fact that the full extent and impact of the financial crisis cannot yet be truly appreciated. Moreover, much of the existing literature on this subject is theoretical in nature and use as underpinnings statistics that are sometimes projections or expectations. That said, effort was made to crosscheck statistics deemed particularly important to this research, although the reliance on secondary data necessarily invites some degree of disagreement. Additionally, this study was unable to make use of primary research methods, such as interviews and field research, due to time and space constraints, and the considerable costs that would've resulted from such research. These constraints of space and time also limit the scope of this assessment. While comparing the two selected cases offers a valuable and viable comparison study, because of its limited purview this study is unable to discount absolutely the possibility that the observations discussed herein are exceptional.

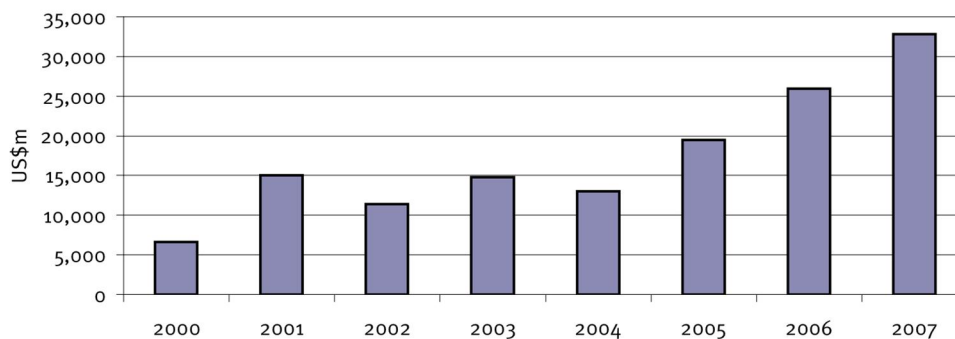
It is also necessary to note that this study does not attempt to expound upon the debate regarding FDI and growth rates. Any cursory evaluation of the literature on the subject of FDI and development will unearth studies that seek to determine, quantify, confirm, or refute the notion that FDI is correlated with growth (specifically GNP growth). This study does not concern itself with this tangent. While GDP growth rates are touched upon in this study, they are done so to illustrate trends in economic and socioeconomic trajectories, and in no way should the supposition be made that this paper assumes a connection between FDI and growth. Furthermore, while the relationship between FDI inflows and development is elaborated upon in this study, there is a distinct difference between development and growth, and the two should not be confused.

Chapter 2: Background

2.1 Trends in FDI inflows to Mozambique and Tanzania before the financial crisis: a brief background

As a whole, Africa saw remarkable economic development across the continent during the 1990s and early 2000s. A boon in foreign direct investment was enjoyed across the continent, and total FDI grew by \$20 billion between 2004 and 2007 (Macias and Massa 2009: 1). Across sub-Saharan Africa, total FDI inflows stood at a modest total of just over \$5 billion in 2000, but had rocketed to over \$30 billion by 2007 (see Figure 1, below) (Ibid.: 4).

Figure 1 Net FDI inflows to SSA, 2000-2007 (US\$ millions)



Source: Macias and Massa, 2009

Individually, Mozambique and Tanzania saw their FDI inflows grow dramatically: Mozambique's FDI inflow grew from \$245 million in 2004 to \$427 million in 2007; Tanzania's rose from \$331 million to \$600 million over the same period (UNCTAD, 2009). These gains

were directed toward industries that had previously been given preference by FDI trends during the 1990s. From 1990-1999, Mozambique received a total of \$1.542 billion in FDI inflows, of which a total of \$1.334 billion went into mineral and resource sector development, including aluminum and other metallic facilities (Goldstein, 2004: 61). Tanzania's FDI distribution by the close of the twentieth century also decidedly favored the minable resource and manufacturing sectors (see Table , below).

Table 2 Stock of FDI by Sector, 1998 and 1999 (in USD millions)

Sector	1998		1999	
	Amount	Percentage	Amount	Percentage
Mining & Quarrying	503.6	30.8	848.9	39.4
Manufacturing	406.4	24.8	475.4	22.1
Wholesale, Retail Trade, Catering & Accommodation Services	251.7	15.4	281.4	13.1
Agriculture, Hunting & Forestry	119.5	7.3	151.4	7.0
Finance Insurance, Real Estate & Business Services	133.9	8.2	147.7	6.9
Construction	106.9	6.5	120.8	5.6
Transport, Storage & Communication	49.5	3.0	60.0	2.8
Others	29.5	1.8	31.6	1.5
Community, Social & Personal Services	1.4	0.1	1.8	0.1
Electricity, Gas & Water	35.4	2.2	35.4	1.6
TOTAL	1,637.7	100.0	2,154.4	100.0

Source: Tanzania National Bureau of Statistics

These appreciable gains in FDI inflows experienced by Mozambique and Tanzania during the past decade-plus were preceded by rigorous economic reforms during the 1980s, during which both countries sought to make themselves more attractive to foreign investors. Mozambique, which set about instituting reforms during the 1990s to make their economy more attractive to FDI, established the Mozambique Investment Company, which became fully operational by

1998, to encourage FDI inflows to the country (Makola, 2008: 8). It is important to note, however, that much of the reforms undertaken in Mozambique implemented after aid supplied by the International Monetary Fund, which initiated a stabilization program in the country during the late 1980s (Bruck, 2006: 35-36). Once left to its own devices, the government of Mozambique instituted changes which facilitated the growth of FDI inflows, such as the lifting of domestic price controls and the liberalization of foreign trade, both of which were positive signs to investors that Mozambique was eager to attract and retain FDI (Ibid.: 36).

In 1985, Tanzania undertook a series of reforms to attract foreign direct investment, shifting more towards a market-based economy. These included parastatal reforms, such as the privatization of state owned companies; investment-inducing reforms such as guarantees against nationalization of economic sectors (such as the manufacturing industry); and financial sector reforms, including the privatization of state owned banks and the opening of the banking sector to foreign banks (Tanzania National Bureau of Statistics, 2001). As these reforms began to come to fruition, the country witnessed a marked increase in FDI during the mid-1990s, and the government further bolstered their position through the creation of institutions designed solely to attract and promote foreign direct investment, such as the Investment Promotion Centre (IPC), which was tasked with inviting, promoting, and monitoring FDI inflows to the country (Ibid.).

2.2 Emergence of the financial crisis and its spread to and impact on sub-Saharan Africa

The emergence of the financial crisis is a complex phenomenon that requires elaborative explanations to be truly sufficient. Although this paper will not provide a detailed account of all reasons and consequences of the crisis – which would be outside the scope of this study – it is convenient to discuss some important points, given the fact that doing so provides a context in which to understand why and how the crisis is correlated with FDI flows.

The financial crisis that has since engulfed the developed and developing world alike began from the collapse of the U.S. housing market in the later months of 2007. Driven by a surge in house prices, financial institutions sought to capitalize on the opportunity by offering loans to subprime (that is, dubiously qualified) borrowers, overvaluing the cost of their home in order to aggrandize the size of the loans, and thus the amount eventually repaid by the borrowers (Baily et al., 2008: 7). Following this, financial institutions sought to further their financial gains by packaging and securitizing these subprime mortgages, which with “AAA” ratings were then sold to investment banks (James et al., 2008: 6).

With the sale of these securitized mortgage packages to foreign mortgage lenders, the US financial crisis quickly became a global calamity. Northern Rock, the mortgage lending giant in the United Kingdom, became heavily entangled with these poisonous assets and, unable to

secure returns on them, began to develop liquidity issues during the summer of 2007 (James et al., 2008: 9). The bank's share of the UK domestic mortgage lending grew from 3.6 percent at the turn of the century to 9.7 percent by 2007, a position that caused their capital to disappear without return on these investments and forcing the bank to turn to the Bank of England to guarantee their financial solvency (Bank of England, 2008).

As the entire developed world became embroiled in the crisis, it was only a matter of time before the developing world, so heavily dependent on financial inflows from the former, began to feel realize the consequences of drying financial liquidity for foreign aid and investment. It is also necessary to recall that country characteristics will make some better suited than others for dealing with the fallout of the financial crisis. As it happens, most sub-Saharan African countries are decidedly unequipped to deal with such a dip in financial inflows, and, according to the World Bank, African countries which were most prone to suffer during periods of economic depression and recession are those which are either: heavily dependent on FDI; reliant to an excessive extent on aid; have big current account deficits –disregarding their use or not of FDI; or whose government have deficit spending (Velde, 2008:3 -4).

Therefore, and in spite of Africa's weak integration into the global financial markets of the developed world, the landscape after the crisis seems to suggest serious problems. As mentioned, GDP growth will plummet to 1.7 percent, lower than the population growth rate (Shah, 2009). South Africa – sub-Saharan Africa's biggest economy and a vital trade partner for many countries in the Region, including Mozambique and Tanzania – has already begun to feel the maladies of recession. Foreign Direct Investment overall will decrease, and imbalances in the

balance of payments will complicate debt repayments (Ibid.). Clearly, the aforementioned considerations have pervasive consequences and costs for the social dimension within African countries.

Although similar effects of the crisis in the developed world are also to be found in developing countries, the consequences for the latter are more complex because of the loss of wealth, the strain placed on their available credit, and the contraction in aggregate demand for their goods, as many developing countries' economies, and especially those found in sub-Saharan African, are heavily agrarian. Furthermore, while in developed countries risk aversion after the crisis will not necessarily extend to include instruments like bonds, in developing countries risk is associated with public bonds, what leads capital owners to seek refuge in financial instruments issued by developed countries and therefore implies an outflow of very much needed capital from developing towards the developed world (Frenkel and Rapetti, 2010: 697-698).

In addition to the specific risks mentioned above, and as the section on the effects of the crisis for capital flows mentions, developing countries have suffered other negative consequences from the crisis. First, there is the risk of financial contagion towards financial markets in developing countries. Second, there are also other areas in which developing countries can be affected depending on their characteristics, including decreasing aid, decreases in export prices, decreases on the demand of exported goods (i.e. countries like Mexico exporting towards US markets will see demand of their goods decreased) and, of course, a decrease in commercial lending (Velde, 2008: 1-4)

With regard to the developing world, and particularly Africa, the World Bank Chief Economist for the region, Shanta Devarajan, affirms that the crisis negatively effected GDP figures, reducing the continent's GDP growth from 5.7 to 1.7 percent (World Bank, 2009). What is more, between seven and ten million Africans saw their income reduced to a level below the poverty line threshold, and between 30,000 to 50,000 children died within their first year of life as a consequence of hardships directly attributable to the crisis (Ibid.).

2.3 How the financial crisis has affected FDI inflows to sub-Saharan Africa

There are different transmission mechanisms through which the financial crisis affects developing countries in sub-Saharan Africa, including trade, remittances and capital flows (Griffith-Jones and Ocampo, 2008:1-2). As mentioned, this research will focus on the third of the aforementioned mechanisms – capital flows – which encompasses the transmission of foreign direct assistance.

The effect of the crisis on capital flows in general and FDI in specific could mean a decline of 20% by the year 2008, bringing about an end to a period of sustained growth that reached an historical peak of \$1.8 trillion in FDI funds in 2007 (Ibid.: 1). In addition, the decline that followed from this 2008 apex was expected to be prolonged, as the crisis continued to engulf multinational corporations, sapping them of investment capital which would otherwise have been allocated for FDI (UNCTAD, 2009a: 1).

According to UNCTAD (2009a), this sharp decline in FDI to SSA is the product of a twofold process: first, firms have seen their access to finance constrained, thereby diminishing their investment capabilities; this decrease in finance comes both from their decrease in profits and from the resilience on the part of the banking sector to lend capital in the wake of the financial crisis. Second, inclination to invest has also been affected by the economic forecast, which expects (or has already witnessed) a continuation of the worldwide economic recession. In turn, this affects the adversity to risk among companies, and therefore further contributes to a reduction in FDI (UNCTAD, 2009a: 2). By extension, it can be expected that those sectors experiencing diminishing prices will also experience diminishing FDI inflows (Jones and Ocampo, 2008: 4).

From this, a generalized expectation can be offered wherein firms will either scale down their investment as they face a contracting demand, or redirect their capital to within their home countries as soon as an improved investment climate allows. On a related note, there is a significant relationship between the banking sector of SSA, and in specific Mozambique and Tanzania, and the inflows of FDI and other capital forms. Indeed, throughout much of the early years of the twenty-first century, foreign banks began buying up stake in the African banking sector, either by purchasing ownership shares and/or through the provision of capital investment (Boorman and Christensen, 2010: 75). This, then, has had a dramatic impact on the banking industries within these developing countries during the financial crises, as foreign ownership showed an increased proclivity to transfer the capital from these subsidiary banks in SSA back home to the financial houses in the developed countries (Ibid.: 75-77).

Within the landscape described in the preceding paragraphs, there is an implication that FDI inflows to SSA will be reduced either en masse or indiscriminately, yet in spite of this, it is important to note that the impact of the crisis on FDI inflows to SSA will not be consistent through the subcontinent, but rather will vary according to region and location. This is a natural product of the inherently subjective nature of FDI. Moreover, and seemingly paradoxically, the financial crisis has thus far most significantly retracted FDI inflows to developing Africa countries with economies based heavily around natural resources (such as Angola and Nigeria), though even this must be appreciated with the understanding that these countries have received a higher share of total FDI inflows to SSA to begin with, and were therefore positioned to lose more (UNACTAD, 2009a: 5).

Chapter 3: Analytical Framework

3.1 Defining foreign direct investment

According to the Organization for Economic Cooperation and Development, which established a benchmark definition for foreign direct investment in 2008 that is consistent with previous definitions used by the International Monetary Fund and other international organizations, FDI constitutes ““a category of cross-border investment made by a resident entity in one economy (the direct investor) with the objective of establishing a lasting interest in an enterprise (the direct investment enterprise) that is resident in an economy other than that of the direct investor”” (OECD, 2008). The obvious necessary components within this definition include the cross-border (and thus “foreign”) relationship between the investor and enterprise, and the long-term quality of the investment, or so-called “lasting interest” of the investor in the enterprise. Another component of the definition, and equally important, is that foreign direct investment implies ownership – according to this OECD definition and those preceding it, a share equal to or greater than 10 percent.

When a Japanese car manufacturer invests in production and distribution enterprises in the United States, this represents an instance of foreign direct investment (from the auto company into the United States). This paradigm can be mutually beneficial, in that the investor is able to gain from the expansion and diversification of their business, and from the revenues from returns on investment, while on the other side, evidence continues to suggest that FDI grows the economy of the recipient country in several ways, including: the triggering of technological spillovers; the

formation of human capital; the facilitation of international trade integration; and the increasing competitiveness it provides the business environment through enterprise development (OECD, 2002).

3.2 Determinants of disbursement of foreign direct investment

Conceptualizing the determinants of FDI disbursement is inherently subjective and theoretical in nature, given that no two countries will offer exactly the same investment climate (making a precise comparison impossible), nor will any two investors be motivated to act on the same variables or have the same predilections although a considerable (yet divided) number of works have attempted to quantify FDI determinants. It is prudent to begin any discussion on determinants of FDI disbursement by compartmentalizing the issue into two categories: “host-country” determinants, including but not limited to market size, openness to trade and investment, and political stability; and “industry-specific” factors, such as investors’ opinion and econometric studies (Overseas Development Institute, 1997: 5). For the purposes of this study, discussion herein will be focused on the former, given that this research is concerned with the recipient-side (that is, the countries) of the relationship, and because an understanding of host-country factors allows for an appreciation of the information upon which investors make their decisions.

In its analysis of host-country determinants on the disbursement of FDI in developing countries, the Overseas Development Institute (ODA) (1997) lists the broad categories of determinants under which fall most of the factors discussed by other authors on the subject. They include

market size, openness, labor costs and productivity, political risk, infrastructure, incentives and operating conditions, and privatization (Overseas Development Institute, 1997: 5-8). While a true consensus is evasive, literature focusing specifically on FDI determinants to developing countries (which would include both Tanzania and Mozambique) finds that existing infrastructure, incentives and operating conditions (including potential returns on investment), and openness to trade are significant host-country determinants of FDI, with another important determinant being host-country natural resource endowment (see e.g. Asiedu, 2006; Asiedu, 2002; Nunnenkamp, 2002). Interestingly, they also seem to suggest that stability is not a significant factor in determining FDI.

When reviewing the role of infrastructure in inviting FDI, Asiedu (2002) appropriately states that infrastructure itself is not a determinant of FDI disbursement, but rather *reliable* infrastructure is. Foreign investors have little utility in infrastructure that is not reliable and consistent. Another complementary attribute of reliability is the availability of infrastructure, for even if existing infrastructure is reliable, it must also be robust enough to accommodate the needs of foreign direct investments. It might also be valuable to think of infrastructure reliability on an institutional level, in that monitoring authorities or other offices within a country created specifically to monitor FDI and FDI infrastructure, these offices must themselves be reliable, otherwise no guarantee of infrastructure reliability can be given.

In looking specifically to SSA, Nunnenkamp (2002) argues that openness to trade is a significant determinant of FDI. Although it seems to hold true as an indicator in other areas of the world as well, it is particularly true in SSA – including Mozambique and Tanzania – because of the heavy

concentration of FDI into manufacturing sectors in these countries, which implies a need distributive ease and ability in order to profit from production. Taylor's (2000) findings were consistent with this, and suggested that while trade openness is a significant indicator in the manufacturing sector, it is less so in the service sector. These findings, when placed within the scope of our case study countries, suggest openness to trade to be a significant indicator to FDI disbursement attraction, as manufacturing constitutes an important part for their economies – up to 14% in Mozambique, or the third largest sector – and thus a necessary area for attracting FDI inflows (Carvalho and Sousa, 2009: 5).

Asiedu (2006) provides one of the most compelling analyses, especially pertinent for this study because she focused on sub-Saharan Africa. She reasserts the position that stability is actually a rather weak corollary to FDI deterrence and expounds upon it, assigning stability and a number of other variables a numerical score to determine its affect on constraining FDI (See Table 2). The table is a compilation of controllable factors (i.e. those within the abilities of government to alter or remedy, unlike, say, natural resources or climate), and supports the position that infrastructure, trade climate, and cost uncertainties (such as potential returns on investment, or potential government garnishment of FDI revenue) were important determinants of FDI disbursement.

Table 3 Constraints on FDI to Sub-Saharan Africa: Average rating for each constraining factor²

WBE (1= no constraint, 4=severe constraint)		WDR (1= no constraint, 6=severe constraint)	
Corruption	2.80	Taxes & Regulations	4.50
Weak Infrastructure	2.75	Corruption	4.47
Street Crime	2.70	Weak Infrastructure	4.28
Inflation	2.67	Crime	4.25
Financing	2.64	Inflation	4.11
Organized Crime	2.57	Lack of Access to Finance	3.95
Political Instability	2.43	Policy Uncertainty	3.88
Taxes and Regulation	2.24	Cost Uncertainty	3.75
Exchange Rate	2.15	Regulations on Foreign Trade	3.64

Source: (Asiedu, 2006: 7)

Although it would seem almost axiomatic that political instability and conflict within or involving the target country would be a deterrent to FDI, several studies have posited that it is no more than insignificant. Specifically, Fernandez-Arias and Hausmann (2000) argue that in developing countries, FDI is seen as a much safer investment than other, less tangible investments, and thus crisis and instability are tenuous deterrents to FDI. This reasoning seems particularly apt precisely because of the more material nature of FDI as opposed to other forms of investment; while a financial crisis or unexpected interregnum and power grab could suddenly make debt holdings on a ledger disappear, the smelter that resulted from FDI would be far more likely to survive such crises.

² The data compiled within this table was collected from two surveys: the World Business Environment Survey (WBE), conducted by the World Bank from 1999-2000 and surveying 413 foreign firms in 16 countries across SSA; and the World Development Report Survey (WDR), conducted by the World Bank from 1996-1997 and covered 540 foreign firms in 22 countries across SSA. In both surveys, respondents were asked to provide numerical indicators for the extent to which variables constrained their business operations. Higher numbers denote greater constraint. (See: Asiedu, 2006: 6).

Given the consistent dismissal of stability as a determinant of FDI disbursement, and the fact that both countries had received a relatively comparable level of FDI investment before the onset of the financial crisis, stability concerns are not considered assessing the performance of Mozambique and Tanzania against the indicators. Furthermore, natural resource endowment is similarly subordinated, owing to the fact that both countries share similar deposit types of natural resources and because, as demonstrated in the second chapter, FDI has been disproportionately distributed to this sector over other economic sectors in both countries, and at similar rates. Therefore, the key determinants are infrastructure, including the reliability of infrastructure and the reliability of actors responsible for its delivery and maintenance, openness to trade, and incentives and operating conditions.

Chapter 4: Conceptualizing Inward FDI flows to Mozambique and Tanzania

4.1 An overview of the performance of post-crisis FDI inflows to Mozambique and Tanzania

Despite the remarkable similarities that exist between the two countries, FDI inflows to each responded differently to the financial crisis. In Mozambique, evidence suggests that not only did FDI inflows not abate in 2009, but, with the continuation of several FDI-sponsored projects, total FDI inflow to the country will represent an increase over its 2008 level (Carvalho and Sousa, 2009: 5). Meanwhile, Tanzania's 2009 FDI inflow went the opposite direction. According to Emmanuel Ole Naiko, the executive director of the Tanzania Investment Centre, Tanzania would suffer a drop in FDI inflows, although it "could probably be only 10 percent" of a decline from the country's 2008 total (Reuters, 2010).

Although Mr. Ole Naiko seemed to paint the drop in FDI inflow in as positive a light as possible, in truth the divergence of the trajectories of 2009 FDI inflows to these two countries could not be more apparent. Mozambique's FDI inflow for the first three quarters of 2009 was a full \$90 million more than over the same period in 2008 (Bank of Mozambique, 2009). This is very much the product of continued FDI into development projects in the country, but also the commencement of new projects. (This, in fact, is considerably more impressive than the fulfillment of existing projects, considering that there are no sunk-costs to attempt to save or justify with a yet-commenced project, and thus takes both more capital and more confidence to

undertake.) Indeed, the construction of the Mependa Uncua hydroelectric dam in early 2009, and the complementary expansion of the electric grid by some 1,400 kilometers, represents significant investments of FDI that seem remarkable considering the economic climate (Carvalho and Sousa, 2009: 5).

Foreign direct investment inflows to Tanzania have not been so fortunate. While the country's investment official gave a quantitative appreciation for the level of its demise, it is noteworthy that FDI slowdown has occurred in Tanzania in economic sectors shared by Mozambique, while the latter has not experience such significant drops in investment. Indeed, the mineral sector of Tanzania appears to have been one of the hardest hit, with FDI inflows to diamond, gem, and tanzanite projects shelved or postponed, as well as previously-planned smelter development projects (Lizondo and Desruelle, 2009: 47-49; Macias and Massa 2009: 5-6).

4.2 Assessing the performance of post-crisis FDI inflows to Mozambique and Tanzania within the framework of determinants of FDI disbursement

As the discussion on indicators disbursement illustrated, a significant factor in determining a country's ability to attract FDI is its openness to trade. Mozambique, with a slightly smaller economy than Tanzania, has nevertheless worked diligently to open new avenues of trade, and continues to seek new outlets for its manufacturing and agricultural sectors (Carvalho and Sousa, 2009: 6). Moreover, Mozambique was able to maintain their share of export capacity between

2007 and 2008 (with preliminary data indicating a similar trend for 2009) from its manufacturing and mineral sectors (Castrel-Branco and Ossemane, 2010: 11-12). Conversely, Tanzania witnessed a considerable slowdown of its export portfolio between 2007 and 2009 to everywhere except to the East African Community, and even within this market, trade in all sectors declined except industrial goods (Lunogelo et al., 2010: 2-3). Although the increase in export earnings from neighboring countries during the financial crisis, even if just in one sector, is a satisfying indication and a bright spot on an otherwise bleak assessment sheet, it must be considered how such growth, given both the limited area to which these exports were sent and the fact that it was found in only one facet of the economy (industrial goods), will actually serve to encourage FDI. It is highly suspect that a foreign multi-national company will decide to pour in FDI on this basis.

In the mining sector, which has been mentioned as a significant component of both countries' economic portfolio and, considering the obvious cost and complexity often associated with extraction of these resources, stands as an important sector in which to attract FDI. Here again, data indicates that Mozambique was able to capture a greater share of FDI inflows to this sector than its neighbor. So-called "megaproject" FDI, which is foreign investment into huge development projects in the industrial and mineral sectors, actually increased in Mozambique during the first half of 2009, from \$246 million to \$266 million (Castrel-Branco and Ossemane, 2010: 5). Even those megaprojects that did cease operations, such as new titanium and steel factories and a tantalite mining company from Britain, pledged to reopen their doors early in 2009, given the profit forecast within the sector and the belief that demand would again outpace supply (Ibid.: 6).

Such appreciation of investment has not been enjoyed by Tanzania. To the contrary, Tanzania's mining and natural resource revenues declined across the board, with the lone exception being gold, which was spared only because of its value as another form of currency during the financial crisis (Lunogelo et al., 2010: 9). All told, FDI into Tanzania's mining sector dropped by as much as 50 percent between 2008 and 2009, from \$90 million to \$46 million per year, with expectations to continue into 2010 (Ibid.: 9). The reduction in FDI inflows to Tanzania were manifest through the cancellation or postponement of development projects, which meant not only the loss of FDI, but also the loss of domestic growth and national income, through such channels as jobs and taxation. In March of 2009, it was announced that a \$3.5 billion investment in an aluminum smelting project had been postponed, and \$165 million nickel mining project was dubiously "rescheduled" to a later, unspecified date (Macias and Massa 2009: 6)

To understand why Tanzania has performed so poorly in attracting and retaining FDI to their mining and natural resource sector when compared with Mozambique, it becomes necessary to consider another of the significant indicators of determining FDI disbursement. Indeed, as the literature review on disbursement determinants illustrated, a significant factor is the evident incentives and operating conditions (which includes potential returns on investment) offered to companies making foreign direct investment, with the evidence showing the Mozambique has done far more to facilitate and maintain a gainful environment for FDI than has Tanzania. In Mozambique, megaproject FDI in the mining and resource sectors constitutes about 70 percent of total industrial production, yet contributes less than 3 percent of total fiscal revenues for the Mozambique government; of the more than \$1 billion gain in trade value by megaprojects in the

country, a mere \$320 million is ever absorbed back into the Mozambique economy (Castrel-Branco and Ossemane, 2010: 7). Clearly, foreign investing firms are able to enjoy considerable returns on investment, incentivized by their large retention of revenue.

In Tanzania, however, the government approach has been decidedly different. In 2006, the government initiated inquiries and investigations into the mining sector and its megaprojects to attempt to establish ways in which it (the government) could increase its revenues from the sector, finally approving certain restrictions on foreign operators by the twilight of 2007, or just as the financial crisis would begin to seep into the continent (Lange, 2010: 22). Such measures included increasing the government's ability to tax and requiring domestically operating foreign firms to allow small local miners the right to mine in areas bought or managed through FDI (Ibid.: 22-25). In light of this, it is far easier to appreciate why the financial crisis loused so much more FDI projects in Tanzania's mining sector than in Mozambique's. Considering another crucially significant indicator of FDI disbursement, Tanzania once again fostered a more precarious and disadvantageous investment climate than did Mozambique, with operating conditions and incentives conspicuously more favorable in the latter than the former.

What's more, the aforementioned reforms reflect, by extension, an erosion of the reliability of Tanzania's infrastructure when considering it in relation to the reliability of its governing and monitoring authorities. The liberalizing reforms carried out in the 1980s and discussed previously (see: *2.1 Trends in FDI inflows to Mozambique and Tanzania before the financial crisis: a brief background*) can no longer be deemed truly reliable. Indeed, by imposing a new

taxation standard on FDI projects, and by allowing domestic share of FDI holding, the current Tanzanian government is stepping back from the reforms made in the 1980s.

Clearly, when we juxtapose the performance of Mozambique and Tanzania with regard to FDI attraction and retention within the framework of the critical indicators of FDI disbursement determinants, Mozambique has consistently accommodated these indicators while Tanzania has been distinctly less successful in doing so. The striking difference appears to be that Mozambique has realized (or perhaps stumbled upon) the belief that a more laissez-faire approach to monitoring FDI projects translates into a better and more attractive climate, while Tanzania has sought more direct and immediate gains from their economy and existing FDI projects through taxation and regulation. This creates an environment in Mozambique which suggests more consistency with regard to operating incentives than exists in Tanzania. At the same time, it appears as though Tanzania has been less active (or, at the very least, least successful) in opening new avenues for trade, while the active pursuit of new channels of trade and the liberalization of its capital accounts has made Mozambique one of sub-Saharan Africa's most open economies (Clement and Peiris 2008: 21).

4.3 Assessing the neoliberal approach to economic control during crisis

What becomes strikingly clear from comparing the two economic models of Mozambique and Tanzania during the recent years of the crisis is that the former pursued a far more liberal approach to economic oversight than did the latter. Tanzania began instituting stricter regulations even before the financial crisis, including, as mentioned, seizing sanctity of property rights by

opening private FDI project lands to local workers and increasing the government share of revenues from private businesses. In addition, the Tanzanian government has imposed measures to monitor investors within the mining sector and to “spread out the social and economic benefits accruing from mining operations to local communities” (Lange 2008: 23). Without question, Tanzania has favored a capital control approach to economic management, both immediately preceding and during the economic crisis.

Shafaeddin (2009) argues that this is necessary, particularly in a time of crisis, in order to ensure that an exodus of capital does not further damage the economy. While conceding that it’s theoretically possible a neoliberal approach will invite more FDI during times of economic boom, he notes that LDCs should actually adopt a continuous policy of capital control, noting that the fragility of LDC economies make it impossible for them to control domestic capital during a time of crisis following a neoliberal approach. Helleiner (1986) amplifies this logic by noting that the flow of imports can seriously affect GDP growth, and thus LDCs should be particularly wary of controlling their import/export sectors during crises.

Despite this, Mozambique appears to have maintained a far more neoliberal approach to economic management, both before and during the crisis. And, it seems, this has only served to benefit it. As Clement and Peiris (2008) noted – and has been previously stated – it was precisely the liberalization of Mozambique’s economy that allowed it to become one of Africa’s most open economies. Considering the previously discussed determinants of FDI disbursement, with openness of economy and trade being one of the most essential for a country to achieve its greatest possible share of FDI inflows, it would seem that the neoliberal approach is actually

more conducive to FDI attraction, even among the LDCs, than capital account control. Perhaps even more startling is the quantitative evidence, as this study has shown that during the financial crisis (in fact, *especially* during the financial crisis), the far more liberal approach of Mozambique to economic regulation played huge dividends: though its growth rate slowed, it did so at a far lower pace than did Tanzania's, and, more to the point, Mozambique was able to secure an increase in its FDI inflows during 2009, while Tanzania's fell significantly.

Although this study is not intended to wade in to the debate on neoliberal economic policy, this case study offers an interesting opportunity to measure the success of a liberal economic model in achieving FDI growth (let alone stability) during a time crisis – that time which contractors argue is most ripe for capital account control policies – while at the same time contrasting it with the failures of a control-oriented economic model to achieve the same results. Elucidating this point is not tantamount to positing that the latter policy necessarily discouraged FDI inflow while the former encouraged it, although the results are suggestive. Moreover, it is interesting to consider that the fulfillment of the aforementioned important determinants of FDI disbursement necessarily lend an economy to being more liberal and less controlling of its capital flows and development base.

4.4 Policy Implications

The research herein has suggested that policy practices and reform at the host-country level can positively or negatively affect that country's ability to sustain growth in FDI inflow levels, despite the sordid economic environment brought on by the crisis. While GDP growth rates in

both countries were seen to fall, the aforementioned research has shown that, in the case of Mozambique, typical measurements of economic growth and stability had no correlation with the procurement of FDI. Instead, by following an approach to policy implementation that accommodates established indicators of FDI disbursement, rather than acting incongruously with both said indicators and previous administrative policy, realizing FDI inflow increase, even during a time of crisis, is attainable.

The evidence brought forth by this study, when considered against the contemporary debate of neoliberal/liberal economic policies against capital control policies, appears to offer some indication that, even for the world's less developed and impoverished countries, avoiding state capture mechanisms and following a more liberal economic regulatory agenda can potentially enhance a country's ability to attract FDI during times of financial crisis. In this case study, such policy also witnessed a slower rate of GDP contraction, which means that, potentially, liberalist approaches to economic theory have the ability to safeguard LDC economies (which runs counter to Shafaeddin's argument that neoliberal or liberal economic policy will cause an exodus of capital and thus a drastic contraction of growth).

4.5 Theoretical Implications

Owing to the infantile nature of the discussion and analysis on the subject of the financial crisis' affects on FDI inflows to sub-Saharan Africa, much of the analysis in any study is to some degree rooted in data that is suggestive, expected, or indicative, and supports the construction of theory that derives from expectations or likelihoods gleaned from this data. In short, theorizing the impact of the financial crisis on FDI inflows to SSA countries must inherently be rooted in

data that lacks robustness, both because of the brevity of time between the onset of the crisis (especially since its extension to SSA) and today, and because the crisis itself may not be over (at the very least, effects are still evident). That being said, the need for theoretical discourse is vital to conceptualizing the nature of the crisis and its impact on the world (particularly the developing world), and will provide a necessary foundation upon which to base and organize future theoretical endeavors made when more robust and borne out data is available.

Even with the theoretical and empirical ambiguities that cloud current discussion on this topic, much of the literature – some of which has been discussed herein – has portended significant harm to the growth and FDI procurement abilities of SSA. Such arguments tend towards generalization and thus subsume anomalous cases where countries have outperformed expectation. This study illustrates that, contrary to sweeping-statement theories, the impact the financial crisis has on the inflows of FDI to SSA countries depends more on country-specific government policies for attracting (or deterring) foreign investment than does the grander macroeconomic climate. Without question, this paper has put forth the understand that the financial crisis did indeed have a negative affect on Africa economic growth, citing the drop in GDP growth in both selected case studies, though it also supports the theory that the financial crisis did not on its own preclude the growth or continuation of FDI inflows to the continent, as many studies have suggested (see e.g. Macias and Massa, 2009; Griffith-Jones and Ocampo, 2009; Massa and Velde, 2008).

Chapter 5: Conclusion

This study has sought, through a comparative analysis, to explain possible reasons why two markedly similar socioeconomic countries, thrust into the same economic environment, could have such divergent results in their abilities to attract foreign direct investment. The research positioned itself to attempt to explain how these two countries had such dissimilar experiences in attracting FDI during the crisis, and why the country which entered the period of the financial crisis with slightly worse preconditions (smaller GDP, lower FDI, etc.) could so decisively outperform its slightly larger neighbor.

The paper begins by providing a framework in which to appreciate a conceptualization of the relationship between foreign direct investment inflows and the financial crisis. It does so by elaborating on the trends and trajectories of FDI inflows, both to the two case studies and to sub-Saharan Africa as a whole, prior to the onset of the crisis. From here, a brief introduction to the origins of the financial crisis, its spread to the developing world (with SSA in mind), and its immediate effects. The findings show that prior to the onset of the financial crisis, FDI inflows to the continent were robust and steadily increasing, as were other indicators of economic stability, such as GDP growth. After the coming of the crisis, however, the study shows that these trends began moving in the opposite direction, and the crisis had a generally negative affect on FDI inflows to Africa. Yet despite this general trend, one of the case selections saw its FDI inflows move in the opposite direction.

The study suggests that government policy, rather than preexisting and uncontrollable conditions such as resource endowment, can drive a country's ability to secure inward FDI flows even during times of economic uncertainty. The study suggests that this ability is directly related to the government's adherence to meeting recognized determinants of FDI disbursement, which was evidenced by the ability of one of the case study countries to maintain economic and policy conditions which satisfied the important indicators, leading to an increase in FDI inflows despite an economic environment not conducive to such a result. Conversely, the findings demonstrate that the counter case selection, which did not satisfy the discussed indicators, not only did not realize gains in its FDI inflows, but instead sustained a depreciation of its foreign direct investment inflow level from the previous year. Without being necessarily causal, these circumstances provide a framework in which to conceptualize success and failure in attracting foreign investment during an economic crisis.

The cases also present themselves as a critique of domestic economic policy, which is discussed in by study without becoming engrossed in it. It is noted that the country that elected to enact liberal economic policies before the onset of the crisis and maintained them during the crisis weathered the economic tempest better than did the other, which began with an open, liberal economic model but began moving toward a capital-control model.

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