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# The Effect of Foreign Direct Investment on Economic Growth of Developing Countries: The Case of Zambia

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## Authors' contributions

*This work was carried out in collaboration between all authors. Author JL designed the study, performed the statistical analysis, wrote the protocol and wrote the first draft of the manuscript. Authors DM and LN managed the analyses of the study. Author LN managed the literature searches. All authors read and approved the final manuscript.*

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## ABSTRACT

Generally speaking, Foreign Direct Investment is undeniably necessary in almost all economies and can add to a country's GDP when it is injected into an economy with a deeper view of the current economic situation as well as the assessment of appropriate variables of the economy in question. When dealing with developing countries like Zambia, careful measures should particularly be taken as the benefits of FDI can be illusory. It is important to ensure that FDI is employed into a developing economy at the right time, with the right conditions, appropriate institutions and for the

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right reasons. Foreign Direct Investment, just like any other type of cash inflow, is said to add to a nation's economic growth. In spite of the known numerous advantages that FDI brings to the host country, the level to which FDI benefits its recipients or the quality of benefits it brings into the host country is questionable in the case where the host country is a developing economy. It is vital to realize that the benefits that FDI brings to host countries can take many other forms and should be carefully examined before considering its injection into an economy. From another perspective, the flexibility that Foreign Direct Investment has during financial crises of an economy makes it to be considered as a private capital inflow of choice by multitudes. This study proves that FDI has similarities with other better capital flow approaches which are injected more indirectly into another nation's economy (developing nation in this case) by using instruments and are more beneficial and less owner biased. Because Zambia and many more developing countries are more promising, have abundant minerals and have good, flexible institutions and policies, capital inflow to Zambia in the recent past has become increasingly dominated by FDI. Should Zambia encourage FDI while demoting other forms of cash flows? This research seeks to investigate the downside effects of FDI on aspects of the economy like employment sector and to analyze whether it is the best alternative of capital inflow for Zambia as a developing nation and if it can be replaced by better forms of capital inflow. This paper further answers the questions: "does FDI generally benefit a developing country like Zambia?" "To what extent does FDI actually benefit developing economies?" "Are there any other forms of capital inflows that can replace FDI in a developing economy like Zambia?"

*Keywords: Zambia; foreign investment; economic growth; FDI drawbacks; FDI advantages; cash inflows.*

## 1. INTRODUCTION

Many developing countries, including Zambia have taken Foreign Direct Investment as a suitable source of income growth, employment boost, poverty reduction, modernization and economic growth (GDPGR). This is as a result of countries overlooking the numerous disadvantages of FDI which can only be noticed after careful consideration and analysis of the extent to which its benefits go in developing countries. There are substantial amounts of literature in favor of FDI in the business world without considerable attention being given to its negative effects on the economies of developing countries like Zambia. Even though these arguments suggest that there is a positive relationship between Foreign Direct Investment and economic growth, some scholars have not found any link between the two especially in low income countries [1]. With reference to the idea that decentralization of local economies has, the recipient country of FDI does not benefit from the capital investment by the transnational company as it happens with other forms of capital: the returns made in the plants and firms abroad are transferred back to the home countries. As per standard, FDI is supposed to contribute to investment and development in its recipient countries through different channels- not just technology transfer and employee skill advancement. The thought of FDI should not necessarily mean the foreign firm itself but one of

the ways in which it manages to finance itself. FDI is brought up by the thought of forming a business or a sector by an individual or a company from another country into the host country [2]. Usually the target country has natural resources and or has potential in various aspects of the economy. Foreign Direct Investment comes in different forms and types. This entirely depends on the type of companies that are involved and the motives behind the investment. It has been said that FDI, just like cholesterol, is comprised of both the good and the bad type [3]. The Zambian government, just like any other nation will with no doubt be anxious to ordinate more intensive investments and take benefit from it, suppose the effect of the type of capital flow on the Zambian economy is favorable and noticeable. FDI is when a foreign direct investor purchases a company in the target country in the form of a merger or acquisition which sets up a venture or expands the one that is already in existence. More forms of FDI include the acquisition of shares in an enterprise, a wholly owned company can be incorporated or can be a sister company and can take part in an ownership joint venture over international boundaries [4]. Further away from the discussion and argument of literature already in existence, statistical data shows that the values of Foreign Direct Investment in Zambia were \$0.09 billion in 1970 and \$1.9 billion in 2011- having that margin, and the values of real Gross Domestic Product (GDP) of Zambia were \$1.7 billion in

1970 and \$19 billion in 2011. The high margins in these aspects indicate that there should be a connection in existence between FDI (the good type of FDI) and economic growth [5]. It is obvious that levels of FDI inflow to Zambia have raised in the past decade having mining as well as construction sectors receiving the generous portions. The number of jobs created by FDI have also been increasing steadily in the past 10 years especially in the construction and mining industries [6]. This is greatly because of the financial turbulence that Zambia and many other countries experienced in the past years as it seems to be the easiest way of attaining cash inflow during uncertain times. Financial contagion is highly the reason for more of these investors' entrance in Zambia.

Contagion is a huge boost in global market connections after a shock to an individual country – (even a group of nations for that matter) as dignified by the grade to which prices of assets or financial flows make a comovement through trades in the markets relative to that drive [7]. Is the inclination for FDI other than other forms of private capital inflows justified in Zambia? This research sheds some light on this issue by reviewing recent theoretical findings and observation on its effects on a developing country's growth and investment. Foreign Direct Investment is believed to generate economic growth but its impact on some aspects of an economy like employment is mixed.

## 2. LITERATURE REVIEW

The first thing that comes to mind on the mention of FDI is the fact that multinationals invest in foreign countries to outsource labor intensive production to countries with lower wages. If for instance average wages in country A are \$20 per hour, on the other hand, \$2 per hour in country B, wage costs can be reduced by means of outsourcing production from country A to country B. Also, multinational firms tend to seek for a secure supply of commodities and best source for these would be a developing country as it will normally have abundant commodities but probably no proper finances to process them. For this reason, many multinational firms tend to invest in developing countries as it goes without saying- average wages are relatively lower there. In the same vein, some huge multinational firms sought to invest in countries with lower corporation tax rates because lower wages might be outweighed by other costs.

Foreign investment in Zambia is said to create employment opportunities for many citizens. To some extent, as investors are doing business in Zambia, they are contributing to the development of the country through the direct creation of employment opportunities for the whole population as well as transferring up to date technology systems-the downside of these will be discussed later. However, some scholars have argued that the type of jobs created are of very poor quality and must be discouraged [8]. It was observed that human capital has a major part to handle in the development process as it therefore improves the public wellbeing of societies. The prominence of this type of capital (human capital) is notionally superficial, this is so because human capital appears more important as opposed to all other features of production [9]. From this point of view, it can be noted that if the most important variable (human capital) is given out at very low cost (wages) as it happens in developing countries, then there is great harm taking place in those host countries.

During periods of intense economic distresses like financial crises, foreign investment has proven to be by far the most pliable and dependable source of inflow for developing countries. Free flow of capital is favored due to the fact that it allows capital flow from an economy to find the highest return rate [10]. FDI has numerous amounts of advantages which make its typical disadvantages to be overlooked. Some of the main advantages of FDI are that it encourages the opening of new national markets which means it enhances and incorporates policies that bring up the removal of trade barriers therefore allowing for free movement of capital, goods, services and creation of suitable environment for trade [11]. Further, it encourages and allows the flow and transfer of up-to-date technology in host countries especially in terms of capital inputs; that cannot be achieved by enhancing financial investments or the trade in goods and services, it also encourages competition in the domestic input market accordingly. On the other hand, Profits that are generated by FDI contribute to corporate tax revenues to the recipients and the economic linkage among participant countries strengthens their relationship [12]. FDI also allows citizens of the host country to gain training of employees in the process of operating the newly introduced businesses. This has a positive impact on human capital development to the recipients [13]. FDI is a means by which unfavorable terms of trade can be handled. A nation that has high FDI levels has

better chances of exporting finished goods which implies that there would be value added for goods which are to be exported. FDI is also taken as a good source of long-term external financing as opposed to loans from international banks [14]. Foreign Direct Investment can also reduce the difference between revenues and costs, thus, countries involved will be able to make sure that production costs will be the same and can be sold easily. Foreign direct investment is with no doubt beneficial to the employment sector in that it creates new jobs, as new companies are being built in host countries, new opportunities are created. This in turn brings up an increase in income and more people obtain more buying power, which in turn leads to a boost in the economy.

The machinery, equipment and Facilities in general that are brought by the guest nation to the host can increase a workforce's productivity in the host country [15]. Based on these and many more arguments, many scholars have encouraged their countries on the use of FDI as capital inflow in their economies.

Furthermore, past the all these economic benefits, Foreign Direct Investment is capable of helping in the betterment of general environment as well as general public circumstances of recipient countries, for instance, the movement of safer and better tools and knowledge as well as making the economy head to more friendly and responsible corporate policies [16]. All these advantages are best accomplished by developed countries and emerging nations at large.

On the other hand unfortunately, serious consequences of this type of cash inflow is overlooked by developing countries probably because of the intense financial pressures that are faced. The advantages mentioned above come in full effect either when both countries participating in FDI are well developed or when the host country is a developing country but has the rightful regulating institutions in place and it depends on whether or not the flow takes place at the right time of the country's growth [17]. Further, the benefits that come alongside FDI do not increase at the same pace and are not consistent in different countries, they are different in diverse localities and societies.

However, beyond all these seemingly too-good-to-be-real advantages mentioned above, lie FDI's disadvantages which are mostly experienced in developing countries and are paid less attention to. Firstly, FDI is a huge hindrance to

investments that are supposed to happen domestically because when a foreign firm uses its own capital and resources in the recipient country, the recipient country's own emerging firms might have little or no attention as people get the perception that the best products or services come from abroad. In the same vein, the country rendering it might run short of internal or domestic investments as FDI prioritizes external markets over the internal ones. [18]

Secondly, FDI is related with other hazardous situations like when in most cases, Multinational Corporations (MNCs) are likely to be interested in participating in the in-house matters of the recipient country, especially if the recipient nation happens to be in a situation where it is working towards guarding its people's welfares. Multinational Corporations (MNCs) are likely to get rid of Government personnel then fix people who may take their own concerns as a first priority. A developing economy which wants to benefit from Foreign Direct Investment is supposed to initially uplift its economic situation into a sustainable position of a developing state, for fear that the nation may encounter a misunderstanding with Multinational Corporations which might have the reasoning that the nation does not show enough compliance [19]. FDI and Multinational corporations are not a bad idea-however, they tend to be more reliant when they function hand in hand with their matches in terms of economic stability.

The luring of inner springs of capital may not always have opportunities as multinational firms usually want to operate with nations that are not having too volatile capital markets. A boost in the need for loans, are likely to add to their cost. For this cause, the potentials of encouraging or enticing prospective investors are reduced. Furthermore, Foreign Direct Investment may not usually aspire the betterment of the arrangement of manufacturing as well as growth that initially exists in the recipient nations, however as multinational corporations are directed through the product life cycle concept, there exists mainly comovements of technologies and equipment to host countries which operate for reasonable periods without renewal or advancement [10]. Foreign Direct Investment is more concentrated on the extractive sectors as compared to productive sectors, expansion and development of the manufacturing and infrastructural segments will not grip an assurance of good enough development that would be able to sustain the economy of a developing nation [21].

The presence of multinational companies may have undesirable effects of the ongoing generative process of the recipient nations. Therefore, multinational companies as well as reserves are looked upon as sources of extra financing for internal stock so that the continuously delivered profit returns do not over shoot the investments in question. As improvements take place, citizens and non-citizens may have attained some kind of cultured arrangement in the walloping and usage of the returns that come in from tax. There is illegal exports of capital which are extremely different in those times [22].

The fact that jobs are created in the process of FDI's injection into an economy is a good one, but carefully examined, the types of jobs created involve manual laboring as the managerial positions (and better salaries for that matter) are given out to the personnel from the visiting country.

As seen here, FDI might indeed have the potential of reducing poverty levels in recipient countries in many different ways as mentioned above -it is the quality and extent to which these advantages go that is worrisome. Even though the world has substantial evidence that extensive investment benefits host countries, potential impact should be carefully assessed and looked at in a realistic way. Nations having financial assets that are sold in international markets and whose local financial markets are a little more liquid are likely to be more susceptible to financial pollution [23]. Variation of monetary diversities globally involve the inter-market evading of macroeconomic dangers, nations in which asset yields show a high percentage of movement with a crisis-affected country in tranquil periods will be more defenseless towards financial contamination [24]. Genuinely good capital flows are supposed to go to countries that have more financially stable economies, more developed, more open, more advanced and having better institutions. However, the above mentioned factors tend to reduce the share of FDI in capital flows, therefore a larger share of FDI in capital flows is seen to go to countries that are poorer, more closed, riskier, highly volatile, more distant, less financially developed, with weaker institutions but having more natural resources [25]. There is no record in history where a nation obtained its economic stability through FDI being its reliable source of income/ economic growth. Foreign Direct Investment is only beneficial to a nation's economy when the nation in question is currently approaching the

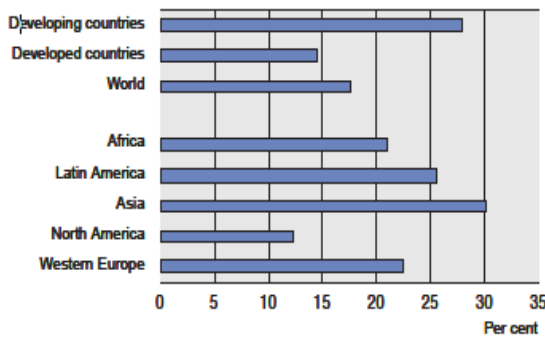
developed stage. This is observed in almost every era: and there are examples like in South Korea and Brazil, in Germany also after the 2<sup>nd</sup> world war, Japan followed Germany, even in England, China, India, Vietnam, Malaysia, the list goes on [26]. Currency flows are not all the same. As it was observed in the case of cholesterol, there is the good and bad kind of capital flow. The good kind – foreign direct investment (FDI) – brings with it technology, managerial skills and market access and thus increases growth and development [27]. Moreover, the good FDI is prominently nailed down and cannot leave so easily at its earliest encounter of trouble. The good FDI is usually attracted by long term prospects which complement the confidence that its policies and institutions inspire. The bad cholesterol comes alongside debt, especially of the short-term. The bad type of FDI is usually moved by hypothetical thoughts built on grounds of interest rate differentials and exchange rate prospects, instead of long-term measures. Its motion is usually influenced by the result of ethical misinterpretations like implied exchange rates guarantees or even the readiness of the governments in question to bailout the available banking systems. Bad FDI is said to be the first to depart in hard times. This bad FDI is said to be the cause of the past boom-bust sequences in the 90s [28,29]. Countries like Zambia usually end up stuck with the bad kind of FDI- the bad cholesterol. Over the years, FDI has proven to be a strong and dependable form of capital flow especially during a phase of financial crisis. Notable examples are East Asian countries, where investment was seen to be undoubtedly stable during the 1997-1998 global financial crises. On the other hand, other ways of private capital inflows—portfolio equity and debt flows, especially short-term flows—were exposed to large declines during the same period [30,31]. Moreover, FDI's resilience during financial crises became obviously true by simple observation during the 1994-1995 Mexican crisis and the 1980s Latin American debt crisis. The resilience that FDI had during these periods could lead many developing countries to favor it over other forms of capital flows, advancing some sort of style which has been in existence for a while.

## 2.1 General Structure of Foreign Direct Investment

Developing countries get a partial share of FDI which is distributed unequally. There is seen to be heavy focus on some countries as opposed to

others as the case is seen in Asia for instance China as well as Singapore. Moreover, Foreign Direct Investment comovements show greater quantities of inflows into developing countries, a few of them showing extents of Foreign Direct Investment almost equal to their domestic economy. In the current situation, the flow of Foreign Direct Investment that goes into developing countries globally outshines authorized growth with a huge difference, moreover emphasizing the essentials of attending to the usage of Foreign Direct Investment as an instrument for GDPGR.

**Inward FDI stock (2000 Share of GDP)**



**Fig. 1. Inward FDI stock (2000 Share of GDP)**  
 Source: UNCTAD. (United Nations Conference on Trade and Development)

Great amounts of Foreign Direct Investment coming into the country established high account of history over the past 10 years and that was prior to seeing the levels dropping in the year 2001.

Around the year 2000, the global overall inflows got to as much as 1.3 trillion United States dollars [32].

## 2.2 Foreign Direct Investment in Africa

Attraction of Foreign Direct Investment to Africa in the past few years is mainly because of the abundance of minerals and natural resources in general in the target nations-this is the more reason why those countries with plenty natural resources are seen to have attracted more FDI compared to the ones with scarce resources. Moreover, the dimension of activities in the local economies in the host nations also contributes to this attraction. The main reasons behind this uninspiring Foreign Direct Investment inflow to most parts of Africa are obviously similar features that add to a generally small proportion of private ventures to Gross Domestic Product throughout Africa. Studies have attributed this to the fact that, while gross returns on investment can be very high in Africa, the effect is more than counterbalanced by high taxes and a significant risk of capital losses. As for the risk factors, analysts now agree that three of them may be particularly pertinent: macroeconomic instability; loss of assets due to non-enforceability of contracts; and physical destruction caused by armed conflicts. The second of these may be particularly discouraging to investors domiciled abroad, since they are generally excluded from the informal networks of agreements and enforcement that develop in the absence of a transparent judicial system.

## 2.3 Share of Chinese FDI in Zambia

There has been declining and inconsistent growth in Zambian economy since her independence in 1964. The citizens took over control of government but one of the most important sectors in the nation (economic sector) remained in the control of non-nationals: the Europeans to be specific. Foreign Direct.

**Table 1. FDI out flows by region**

OECD FDI outflows by region							
1985	1990	1995	2000	1985	1990	1995	2000
61277	235836	335194	1068786	100	100	100	100
42055	189166	263716	904349	68.6	80.2	79.7	84.6
19222	46670	71437	137747	31.4	19.8	21.3	12.9
404	195	3100	7267	0.7	0.1	0.9	0.7
2171	12650	25106	29494	3.5	5.4	7.5	2.8
8	408	3570	14026	0.0	0.2	1.1	1.3
9101	18948	23632	6834	14.9	8.0	7.1	6.4
212	1056	1936	1571	0.3	0.4	0.6	0.1
7325	13413	14093	17015	12.0	5.7	4.2	1.6

Source: Organisation for Economic Co-Operation and Development

Investment that comes from China into Zambia accrued to US\$2.6 billion and by 2014, there were more than 500 firms from China investing in various sectors of the country's economy [33]

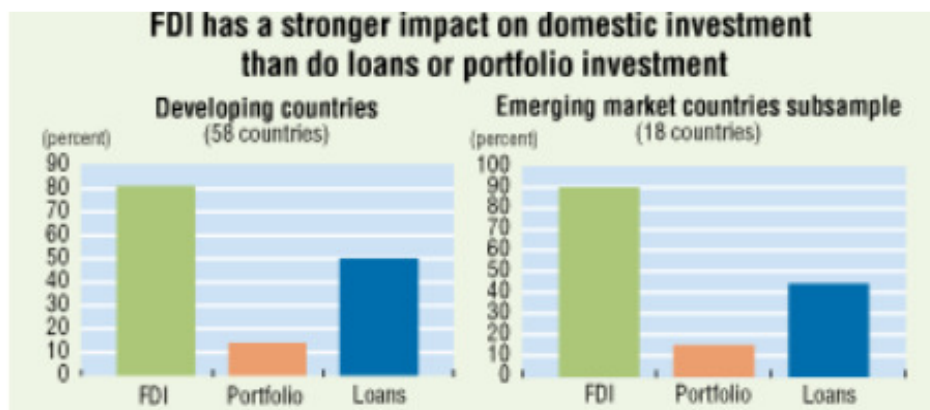
## 2.4 Negative Impact of FDI on an Economy

In spite of positive evidence in existence, other observations indicate that developing countries must carefully take into consideration their view on the benefits of FDI before actually injecting it in their economies [34]. Regardless of whether or not in some foreign-owned firms, wages are higher than in locally owned firms, also whether or not, they spill over to domestically owned firms, higher level of foreign ownership could affect the average level of wages in an industry or country as a whole [35]. If a company from one country creates jobs in a foreign country by opening a branch in that country, there is a possibility that those jobs created are not exactly going to be white collar in the host country as it is in the country of origin. Cheap labor with not so good working conditions are usually the kinds of jobs created in host countries [36]. It was further noted in another research that international transfers and financing are actually only economically beneficial and impactful for upper middle income countries –moreover, poverty is usually viewed in terms of income and that societies are seen to be in deficiency economically once they lack income as well as capitals needed for the satisfaction of general needs of life for example amenities, nutrition, as

well as goods and services [37]. Foreign Direct Investment is in fact, an extension of corporate control over international borders [38]. A study in the past shows evidence on the impact of capital inflows on internal investment for 58 developing countries in the period 1978-1995. The study covered nearly all Latin America and Asia, as well as most African countries. Three types of capital inflows were covered: FDI, portfolio investment, and other financial flows i.e. primarily bank loans [39].

A recent study found that a dollar increase in capital inflows is associated with an increase in domestic investment of about 50 cents. (Capital inflows and domestic investment are in GDP percentages.) However, these results hide huge differences among all the types of inflows. If these differences are to be critically looked into, it will be discovered that they possess some complications which will not be talked about in this paper. FDI appears to bring about a one-for-one increase in domestic investment; equally there is no real link existing between portfolio inflows and investment (there is very little or no effect). The effect of loans lies in the middle of the other two [40].

These findings could have been positive for other countries but sure have illusions for a developing economy like Zambia owing to the fact that there are follow up questions to be asked like: is it at the right time? Does it meet the appropriate policies and institutions? Is it for the right reasons?



**Fig. 2. Proof that FDI can actually be beneficial and less biased with consideration of right timings, right policies and good conditions at the time of injection in a developing economy**

Source: based on Bosworth and Collins (1999)

NOTE: The height of each bar represents the estimated impact of the indicated capital flow on domestic investments. For example, in the left hand panel covering developing countries, every dollar of FDI increases domestic investment by an average of 50 cents that is by 50 percent of the amount of FDI

**Table 2. Proof that better economic policies can bring the good kind of foreign investment**

Year	Indicator					
	Exchange rates	FDI (US \$m)	Portfolio investment (US \$m)	Loans and credits	Real growth	Poverty rates
1998	1862	238	1	247	-2.0	73.0
1999	2388	86	1.0	95	2.4	72.0
2000	3111	121	5.6	247	3.6	71.4
2001	3611	71.7	7.5	287	4.9	70.6
2002	4307	298.4	0.3	187	3.3	69.8
2003	4734	347.0	2.3	127	5.1	69.0
2004	4779	364.0	0.1	134	5.4	68
2005	4464	356.0	122.4	85	3.3	66
2006	3600	615.8	50.4	95	6.2	64
2007	4002	354	41.8	267	6.3	62

Sources: CSO, MOFNP and BOZ

FDI if not carefully natured can cause contagion in developing and volatile economies like Zambia. Contagion refers to the outbreak of market turbulences-mostly on the weakness from a named country to the other, it is a progression detected through shifts in essential factors such as rates of exchange, sovereign spreads, prices of stock, as well as capital inflows.

It was discovered that after many years of volatility in the economy of Zambia there are records displaying consistency in growth that has occurred. On the other hand, the level of growth that FDI seems to bring in the country still seems too minimal to actually influence GDPGR or reduce poverty in any significant way. There is no impact on poverty levels which have kept on increasing. Economic growth has been partly enhanced by increased investments in the economy. Moreover, the emerging of a variety economic policies which were aimed at wooing investors made foreign direct investment to increase from \$238million in 1998 to \$ 354 million in 2007.

After some analyses and considerations, it was concluded that a high share of FDI in a nation's total capital inflows may prove a nation's feebleness in institution other than its strengths [41].

### 2.5 FDI's Effects of Openness of an Economy

Is capital flow more attracted to open economies than closed ones? Does FDI flow to countries that are more open? To clear these questions up, there is need to look at the connection between the portion of exports in GDP and the capacity and structure that capital inflows have. It was discovered that the total capacity of capital flows

is positively and strongly related to openness of an economy. An open economy generally tends to appeal to proportionally more foreign capital.

The portion of Foreign Direct Investment in capital flows does not rise in those economies that are more open. The ratio of FDI to GDP is certainly associated with openness, but it was concluded here that it is only because of the effect of openness on the total size of capital inflows unlike because it affects the share of FDI in the composition. Openness increases all forms of cholesterol (Cash inflows): it does not skew the composition towards FDI.

From here it can be noted that as open of an economy as Zambia is, there is no doubt FDI will be highly attracted to the country but it's all up to the nation to choose and put up policies to control and regulate it's movement.

### 2.6 When is FDI said to have Taken Place?

Looking at the general idea of international capital activities, we know that they are all based on abundance and cost of capital according to various nations. FDI happens when a certain nation, say country 1 makes a direct investment into the second nation, say country 2-there certainly is a raise in the physical wealth of the host,-country 2 in this case. This will automatically bring an addition to the production capacity that is already in existence in nation 2. The investing firm from country 1 has decided to utilize part of its own capital in country 2's economy other than where the firm is originating from. This action will lead country 2 to benefit from production (If the output is tradable) that was wholly supposed to have taken place in



country 1. The production taking place in country 2 may take the place of the production that initially happened in country 1. In another instance, the firm that is investing in this case may have minimized the initial production activities in its initial country. This could happen by selling off or abolishing an existing plant or firm in its former country and setting up a new firm or plant in the host country but maintain the same market it did in the country of origin.

From another perspective, FDI happens when a named firm in nation 1 makes a direct investment in nation 2, and decides to maintain the same stock of physical capital as well as the level of production in both nation 1 and nation 2. The owners and managers from nation 1 in a named industry will be using the knowledge and skills they have attained in their home country production activities and purchase nation 2 workers having minor skills in that industry and operate the firms or plants in nation 2 more professionally as compared to before. The owners from nation 2 who have just been bought out may use their capital from the acquisition in new industries. Alternatives are that the owners of the newly purchased firm/plant in the new industry may choose to lend out the new plant to other managers and owners in country 2 who are well skilled in that new field/ industry so that they are eligible to in turn buy out owners who are not as competent in that industry in nation 1. In this case, net comovement of physical or financial capital implied is not really there, even if it could take place.

firm and a local one have clear and direct connection; it also comprises of equity investments, intracompany debt and reinvested earnings. Portfolio Investment represents other corporate equities and bonds. Long Term Investment includes other public and private sector debt securities, trade credits, loans, deposits, and other assets with maturities of one year or more [42].

There are many different ways of grouping capital flows. Here, FDI will be compared only with one other form of foreign capital flow: portfolio investment (PI).

FDI implies the establishment of direct business of interest in a foreign nation, which could be buying a company or even the establishment of a manufacturing business, whereas foreign portfolio investment is an equity investment made in financial assets, like stocks or bonds, in a foreign nation. Further, FDI tends to involve establishment of more of a substantial, long-term interest in a foreign economy and because it involves significantly higher levels of investment, mostly multinational companies are more than usual interested in its pursuit. FPI on other hand typically has a shorter time period for investment return as opposed to FDI. As it is an equity investment, investors that engage in FPI usually expect quick profit on their investments while FDI investors expect a long run return.

## 2.8 Past Arguments about FDI

There has been various great conclusions which have been drawn from past researches, some of which will be used here in reference.

Firstly, it was observed that the total capital flows (all types of cash inflows) always increased with the level of economic growth. However, the portion of those flows that come in terms of Foreign Direct Investment tends to reduce with the level of growth. In other words, Foreign Direct investment seems to be a substandard good as compared to other cash inflows given that its portion tends to fall with income. Foreign Direct Investments' percentage is very high in nations with a lot of industries. A good example would be Latin America where the levels have been remarkably high recently, this is not necessarily because the whole number of cash flows has been high, but owing to the fact that the percentages of those flows that take the form of FDI has been strangely high in both ancient and modern times. This is in reference to regions that are middle income like Middle Eastern Europe as

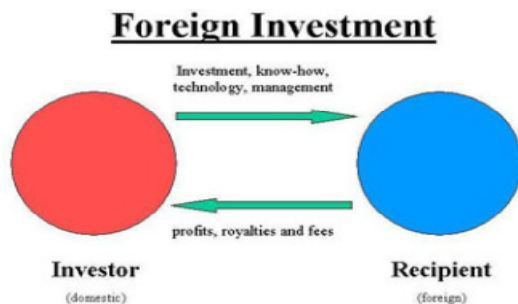


Fig. 3. When is FDI said to have taken place?  
Sourced: globalization 101 [20]

## 2.7 Foreign Direct Investment against Foreign Portfolio Investment (FPI) and Debt Inflows

Foreign Direct Investment and Foreign Portfolio Investment are alike in some ways but tend to be very different in others. Direct Investment is made up of capital connections in which a foreign

well as East Asia. Looking at Africa as well as Asia, the proportion of FDI to GDP is low because low capacities of total capital are not compensated by very high shares of FDI in the combination. This is a first piece of evidence that there must be something wrong with the conventional wisdom. The portion of the better FDI is not found to be in higher levels in prosperous regions, but the opposite. It is total capital that appears to go up with economic development while the share of Foreign Direct Investment goes down [43].

Secondly, it was discovered that latest dramatic variations in the immensity as well as route of multinational capital flows were seen to have gone along with huge changes in their structure. The significance of those changes greatly depended on the fact that the groups actually stood for economically important dissimilarities. If the groups significantly vary, then the cumulative part of Direct Investment in capital flows into various emerging economies or nations might give a rough touch that the new round of capital inflows doesn't necessarily need to end as sudden as the others did. However, if the classifications are not so unhelpful, Direct Investment is just as significant and useful as any other type of capital inflows. Looking at it in that vein, the changes in conformation give no signal that those nations are any less vulnerable or lessened the destabilization of reverses compared to the way they have ever been. Major upsurge in the degree that FDI could or could not push a country's GDPGR to advanced heights. A variety of means of helping FDI to enhance higher GDPGR exist when a global company expands its business into another nation, it must either look into founding a new plant or acquisition and merger in that nation. Whatever the case, the multinational firm will transfer its present advanced technology and facilities, and capital accumulation to the host country [44]. This does not happen in Zambia, thereby making it very difficult for FDI to significantly contribute to the country's GDPGR.

Further, it was observed that FDI mainly contributes only to the level of technology and capital movement into the host developing country. [45]

## **2.9 To What Extent has Chinese FDI Gone in Africa?**

During the past 25 years, China's economy has gradually changed from largely closed

international trade system of the economy to a more market-oriented economy that has a vast growing private sector and is found to be one of the major players in the global economy. The efforts taken to restructure the economy of China and its resulting efficiency gains have opened up more opportunities and have also contributed to a more than ten times increase in China's GDP since around 1978. As a result of the strong reliable economic growth, China's role in the global economy has become extremely significant and continues to strengthen itself since the beginning of this century. An incident occurred in 2005 where the People's Republic of China (PRC) became the second largest consumer of petroleum products in the world after the USA, and the imports of major natural resources and other resources rose by as much as 20% per year. It has been reported that in terms of foreign reserve holdings, China is now on the second position from Japan. China is making huge overseas investments in raw material deposits, and is seen to still be multiplying its trading partnerships in order to secure consistent supplies [46].

## **2.10 Is Heavy Reliance on FDI a Weakness?**

It was concluded that the increased investment flows into African countries had not worked to the advantage of developing countries as a whole, in spite of the fact that countries of the same status undertook many efforts to attract investment. Dramatic increase in FDI levels in developing nations have been experienced in the past decade [47].

Even if the significance of some of the causes of risk mentioned above are yet to be established, the possible likely risks give the impression that the occasion for taking a shaded view of the likely effects of Foreign Direct Investment is uncertain.

## **3. METHODOLOGY AND DATA**

### **3.1 Data**

This research employs both secondary and primary data in its analysis. For the purpose of this study, primary data was analyzed and interpreted from the distribution of questionnaires and observations in foreign firms in Zambia by the researchers. Secondary data includes previous literatures existing on the topic.

**Table 3. What is the situation like in foreign firms in Zambia?**

<b>Purpose of study</b>	<b>Investigation point</b>	<b>Source of data</b>
Work place regulations.	Salaries/wages in foreign enterprises	Questionnaire distribution among employees in Chinese firms
What safety measures are taken in foreign firms?	Safety in the work place	Primary data; undercover Close observation for a period of time in foreign firms and noting the number of accidents and injuries obtained by employees on duty.
Industrial variation.	What type of industries foreign intensive investments are from abroad concentrated on?	Secondary data: previous literatures
Workplace conditions	Job stability	Secondary data; from existing literatures, observation and questionnaires
Economic situation	Volatility of the economy vs influenced development	Ministry of Finance and National Planning (MOFNP)
Economic situation	Volatility of the economy vs FDI influenced development	Central Statistical Office. (CSO)
Economic situation	Volatility of the economy vs FDI influenced development	Bank Of Zambia (BOZ)

Further, quantitative and qualitative variables were useful in the analysis of data in this study. Quantitative variables were in the form of charts, tables and percentages. The qualitative approach includes the analysis of the field of study and situational observation. There is a belief that the combination of each method of research and data is needed because the findings that relate to each method would be used to complement one another and at the end of the study, enhance theoretical or substantive completeness [48]. Conducting deeper survey in foreign firms in Zambia was highly demanding, so the researchers chose to concentrate on questionnaires and existing literatures in the study. This research made use of the studies that are already in existence and the data sets study on FDIs in Zambia.

At the end of the study, this paper hopes to contribute to the already existing thoughts on the subject matter in Zambia.

#### **4. RESULTS AND DISCUSSION**

There has been observed a widespread of criticism in foreign firms (with Chinese firms topping the list) that are based in Zambia. Observers have noted poor work conditions and malpractices at the work place in foreign companies. There has been repeatedly reports of unsafety and numerous amounts of accidents caused by neglecting attitude by management in the copper mines run by Chinese. Moreover, the

number of strikes encountered in these firms confirm the accuracy of this observation. The fact that a named Chinese owned copper mine was actually closed in the recent past amid safety concerns bears testimony in proof of this situation.

After analyzing the data collected in the questionnaires, the following information was derived: 15 foreign firms operating in Zambia were picked randomly to help in the questionnaire survey and from each firm, 20 workers were picked regardless of age and gender. To avoid biased results, open ended questions were asked in the questionnaires like: 'when do you get your annual leave?' to know if they even have leave days. 'What time do you report for work and what time do you knock off?' to know the number of hours spent in the work place. 'How much are you payed for extra hours of work?' to know if there is something like overtime wages. The results showed that 95% of the employees were unhappy in the following factors: 1) they had no annual leave and were still required to work on weekends 2) when they got sick, regardless of providing a sick note, they wouldn't receive their full wages at the end of the month. 3) Women never got mother's day off. 4) National holidays were disregarded 5) they work for more than 10 hours in a day. 5) During interviews, they were promised to be paid extra money for over time but didn't get any when they actually started working.

In the past few years, the fact that employees in Chinese firms were discontent had implications in the political sector in Zambia. This happened when the leader of the biggest opposition parties began to use the Chinese firm incapability in his campaigns during the 2001 general elections as well as in the 2008 presidential elections, where the leading party was seen almost loosing because of this strong campaign strategy. These political complications brought about consequences in most of the Chinese firms in Zambia and it drew attention to many more nations in Africa who started to realize and accept that the situation was out of hand.

It was shown clearly from the observation that FDI can sometimes abuse developing nations; by both the drawing of resources and using the host country as a disposal site for anything that the visiting nations wishes to get rid of. Given that the investors happen to build a plant in the recipient country, the reason behind is mostly just for show off or exhibition. In reality, it is their own products they intend to sell in host countries- they try to bring out to developing countries the substandard goods or copies of the originals that they make and sell in their own countries or even in more established nations.

## 5. CONCLUSION

From the findings, it can be concluded that Zambia does not have what it takes to actually make FDI beneficial for its economic situation as FDI favors more the well off and stable economies.

The major conclusion from the findings herein for Zambia and other developing countries is that Foreign Direct Investment's benefits exist. However, these benefits do not accumulate routinely and consistently throughout nations. This actually depends on the recipient country. To get to the highest level of FDI benefits from foreign firms, the presence an unlimited empowering environment for business is necessary, which will foster local and overseas investment as well as offering incentives for novelty and skill enhancements as well as adding to a modest corporate situation.

So if poverty can be considered in terms of income, and it has been discovered here that the kinds of jobs created as a result of FDI in Zambia and other developing countries are not of high

standard and their wages are not pleasant, it can be concluded that if FDI is to continuously be relied on by Zambians, the country will not improve its poverty levels. This therefore implies that FDI is not the best source of cash inflow for Zambia.

It is safe to say that the most significant opportunity that comes from FDI in Zambia is the increase of investment in transformation activities and technologies. The citizens of Zambia should consider investing in the inflow of resources that come from the booms in commodities as they try to improve the investment environment. The Zambian government should consider the development of human resources necessary to support in new settings of industries and establish development banks that are necessary to provide financial support to nascent private investors.

Having seen that there is no valid linkage between FDI and GDPGR in developing nations, it is advisable that Zambian government should seriously consider other means of capital inflow that might be beneficial to GDPGR of Zambia. Foreign investments such as Chinese are basically resource seeking as well as market seeking to some extent. With time, they are capable of ripping an economy like Zambia off the little resources it has.

From the recent literatures mentioned above, there is evidence that FDI has potential to harm the economy and is risky for developing economies like Zambia. Therefore it should be avoided whenever necessary.

It is possible for FDI to be reversed. It is possible for financial transactions to sometimes accomplish the FDI reversal such as, the overseas subsidiary is able to derive in contradiction of its security locally afterwards loan the money in return to the mother company. In the same way, as a huge part of Foreign Direct Investment happens to be cross firm debt, the mother firm is able to rapidly evoke it with the course of monetary networks- likely to be high because of adverse range and fire sales; Foreign Direct Investment's paybacks are likely to sometimes be limited as a result of leverage- this, as well as a significant portion of Foreign Direct Investment portion in a country's overall capital inflows is likely to show the nation's paleness in regard to its institutions instead of its power and strength.

## 6. RECOMMENDATIONS

Based on the results and findings which suggest that FDI has more hidden harmful effects than beneficial effects on the GDPGR of Zambia, the following recommendations were drawn:

Regular checkups should be made on the risks to the diversification of the Zambian economy.

New regulatory policies should be put in place to closely monitor the working conditions in Chinese firms as well as other foreign firms. The Zambian government should consider the development of human resources necessary to support up and coming industries and establish development banks that are necessary to provide financial support to promising private investors.

As an open economy, Zambia will continue to attract capital inflows in form of Foreign Direct Investment. It is up to the concerned sections of the government to initiate controlling regulations in relation to the subject.

The country should look at several channels which can support FDI on its way to influence higher economic growth. Firstly, when a multinational company decides to expand its business into Zambia, there should be institutions in place to promptly direct it to either look into creating a new plant or acquisition or merger in the country. In any of these cases, the global firm will transfer its existing advanced technology and amenities, and capital accumulation to Zambia.

It is important to ensure that both government and local firms of Zambia manage to make costly investments, and to extract worthy natural resources because of the high fixed cost.

Since capital comovement and improvement in technology are seen to be the two most contributing factors to the country's economic growth as a result of FDI, high level of technology, and production process should be used to stimulate the efficiency in production and distribution degrees, and the amount of domestic capital stock in Zambia should be ensured and observed. This action will therefore automatically increase the living standards and welfare for both the Zambian citizens and the foreign country in question.

More short term inflows should be employed in Zambia as its economy is a staggering one and needs inflows that can benefit it in the shortest possible time.

Other cash flows into the economy that don't necessarily just bring in technology and employee education should be looked into.

Strategy references for Zambia as a developing country should emphasize more on the betterment of the investment situation involving all the types of capital; inclusive of internal and also external or foreign.

Evaluation between short term and long term cash flows for Zambia should be carefully done. Most importantly, the basis of cash inflows to prioritize over other short term forms of cash inflows over FDI.

Zambian economic analysts should sit down and come up with more short term flows that will bring up more benefits to the country as opposed to the long term ones that in the long run, make the country's economy poorer than it already is.

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## COMPETING INTERESTS

Authors have declared that no competing interests exist.

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