

Institutions as a determinant of foreign direct investment inflows into the Southern African Development Community

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Academic editor: Sheresheva M. | Received 16 April 2024 | Accepted 27 October 2024 | Published 25 November 2024

Citation: Nubong, G., & Ntuli, L. (2024). Institutions as a determinant of foreign direct investment inflows into the Southern African Development Community. *BRICS Journal of Economics*, 5(4), 121–138. <https://doi.org/10.3897/brics-econ.5.e125507>

Abstract

Foreign Direct Investment (FDI) in Southern Africa has been one of the drivers of infrastructure development and economic growth, especially in mining, agriculture, energy, information, and communications technology (ICT). Some of the SADC countries have undertaken serious economic and institutional reforms to encourage the inflow of FDI, particularly to low-income countries of the region, but these efforts have not so far led to the expected increases in investment: the overall amount of FDI remains low, it is concentrated in very few countries and mostly goes to the extraction of natural resources.

Institutions and infrastructure development typically have a positive effect on FDI inflows as they improve investment climate. To examine their role in boosting the FDI flows to the SADC countries, the paper uses panel data econometric analysis with OLS and PCSE. Its results show that the quality of governance, together with the level of economic development, market size, and openness to international trade are the main factors that determine the amounts of FDI flowing into the SADC countries. For some areas, however, the primary need is to combat the rampant corruption and reduce political instability.

Keywords

SADC countries, boosting FDI, institutions, infrastructure development.

Аннотация

Прямые иностранные инвестиции (ПИИ) на юге Африки являются одним из факторов развития инфраструктуры и экономического роста, особенно в горнодобывающей промышленности, сельском хозяйстве, энергетике, информационных и коммуникационных технологиях (ИКТ). Некоторые страны САДК провели серьезные экономические и институциональные реформы, чтобы стимулировать приток ПИИ, особенно в страны региона с низким уровнем дохода, однако эти усилия пока не привели к ожидаемому росту инвестиций: общий объем ПИИ остается низким, они сосредоточены в очень немногих странах и в основном направляются на добычу природных ресурсов.

Развитие институтов и инфраструктуры, как правило, положительно влияет на приток ПИИ, поскольку улучшает инвестиционный климат. Для изучения их роли в увеличении притока ПИИ в страны САДК в статье используется эконометрический анализ панельных данных с использованием OLS и PCSE. Результаты показывают, что качество управления, а также уровень экономического развития, размер рынка и открытость для международной торговли являются основными факторами, определяющими объемы ПИИ, поступающие в страны САДК. Однако для некоторых регионов первоочередной задачей является борьба с коррупцией и снижение политической нестабильности.

Ключевые слова

Страны САДК, стимулирование ПИИ, институты, развитие инфраструктуры.

JEL: H54; O11; P44.

1. Introduction

Economic and institutional reforms undertaken by some of the Southern Africa Development Community (SADC) countries to encourage the inflow of Foreign Direct Investment (FDI) have not so far produced any significant effects. FDI into the SADC member states remains low and concentrated only in very few countries and sectors, unlike in European or Asian regional associations of countries. In a developing region, FDI may become crucial because it can serve as a conduit for capital and technology transfer from one economy to another. Such spillovers “constitute the major contribution of FDI to long-term development due to their contribution to improvements in total factor productivity and their potential to boost capital accumulation, employment and foreign exchange earnings they promote” (Balasubramanyam & Mahambare, 2004, p. 59). This contribution of FDI to technology transfer and diffusion is considered one of the major FDI benefits because “technology is believed to be a vital source of economic growth through capital accumulation and benefits that come with the promotion of trade (Moosa, 2002, p. 87).

The global economic downturn that began in 2008 affected the SADC region so badly that between 2009 and 2010 the total FDI in the region fell by almost 50%. Another problem is that FDI into SADC still largely flow to the resources sector, with countries like Angola, South Africa and recently Mozambique leading the way in attracting FDI to their extraction companies. The SA Development Community therefore needs

to increase its global share of direct investment inflows, at the same time creating conditions for the FDI to flow to the sectors that would enable the countries of the region to participate in some of the global manufacturing production value chains and thus diversify away from natural resources dependency.

The present paper contributes to this debate by examining the role of governance institutions in the promotion of FDI inflows into the SADC region. Governance institutions, both economic and political, typically have a positive effect on FDI inflows through their impact on the investment climate and business environment of the recipient regions (Beri & Nubong 2023). The study ascertains these institutional determinants of FDI alongside other control variables, thus contributing directly to our understanding of the institutional constraints that prevent greater FDI inflows to the SADC region. This will make it possible to isolate such constraints and propose relevant policy interventions that could enhance the inflow of FDI to the region. The rest of the paper is divided into six sub-sections. Section 1.2 gives a brief overview of FDI's performance in SADC; in section 1.3 we offer a review of literature on FDI and institutions. Section 1.4 contains the model specification and data description, section 1.5 discusses our results and section 1.6 concludes the paper.

2. FDI performance in SADC

As many Member States of the Southern African Development Community strive to develop their economies, they rely on investment from other nations to help achieve their long-term economic goals. This is because historically, Foreign Direct Investment in Southern Africa has been one of the drivers of infrastructure development and economic growth, especially in the industries related to mining, agriculture, energy, information and communications technology (ICT) (African Development Bank, 2020, p. 25). Countries and regions with stronger economic institutions, i.e. effective rule of law, a good business climate, secure property rights and market-friendly social norms, are better positioned to attract investment, participate in trade and utilise physical and human capital more efficiently, which results in better growth performance over the long run. FDI generally contributes to economic growth through capital accumulation in the recipient economy, often bringing new inputs and technologies to the production processes. FDI is therefore expected to augment the existing stock of knowledge in the recipient economy: company governance will involve advanced management practices and organisational arrangements while workers will get the necessary training and acquire new skills (de Mello, 1999, p. 134). Although in Africa public investment is typically critical to laying the foundation for an industry (particularly through public provision of infrastructure), private investment is often the main driver of the industrial development and therefore a key to economic growth (Markowitz, 2020, p. 6).

Recognising the importance of FDI, the SADC countries have adopted a number of policies and protocols aimed at attracting FDI into the region, such as Finance

and Investment Protocol of 2006 which has become a guiding financial policy for SADC. This Protocol on Finance and Investment highlights the importance of Foreign Direct Investment in Article 3 of *Annex 1* by encouraging Member States of SADC to promote entrepreneurship in industries that attract Foreign Direct Investment. Similarly, *Article 4 of Annex 3* directs Member States to collaboratively develop a framework for Tax Incentives that will draw foreign direct investment into the region.

Prior to this regional prioritization of policies to attract FDI in the Finance Protocol, the region had experienced significant improvements in annual inflows of FDI from only \$660 million in 1985–95 to about \$5.9 billion in 2000–04. Although South Africa and Angola have historically been the top FDI destinations in the region, new champions like Mozambique emerged in the last two decades because of the discovery of natural gas; in 2010 the Democratic Republic of Congo (DRC) increased its net foreign direct investment inflow to almost US \$3 billion. Seychelles has also boosted its foreign direct investment as a percentage of gross domestic product significantly, approaching 40%. Between 2017 and 2018 seven countries of the region experienced a decline in FDI; these were Angola, Lesotho, Madagascar, Mauritius, Namibia, São Tomé & Príncipe and Zambia. In 2018, FDI more than doubled in South Africa and Zimbabwe. In Zimbabwe, however, the rising FDI flows of 2018 went to very few projects and the low base effect was also at work. In the next year, 2019, the FDI inflows into the country fell to USD259 million and the downward trend is likely to continue owing to the lingering impact of the COVID-19 pandemic on global economic growth. (AFDB, 2020:25). See Table 1 below:

Table 1. Net FDI Inflows by SADC Country, 2017–2018 (USD million)

	2010–2016	2017	2018(e)
South Africa	4,353	2,007	5,334
Mozambique	4,353	2,293	2,711
Zimbabwe	384	349	745
Zambia	1,447	1,108	569
Mauritius	399	443	372
Madagascar	583	389	349
Botswana	249	177	229
Namibia	666	461	196
Malawi	189	90	102
Lesotho	66	43	39
Eswatini	62	-56	25
Sao Tome & Principe	28	41	17
Angola	-190	-7,397	-5,732

Source: African Development Bank, 2020

The SADC countries had struggled to attract inward FDI both from inside the region and globally (See Figure 1). The barriers preventing higher investment and value chain participation within SADC include poor access to financing and its high cost, unreasonable tax policies, high cost and low quality of labour, customs regulations, macroeconomic policy constraints, restrictions on the movement of goods and people (whether formal or informal), infrastructure development, excessive bureaucracy, difficulties in setting up a business, product quality and standards barriers, corruption, and general political risk and uncertainty (Markowitz, 2020, p. 8). So to increase the inflow of FDI into the SADC region and enhance its contribution to the region's economic growth and development objectives it will be necessary to mitigate these risks and remove the barriers.

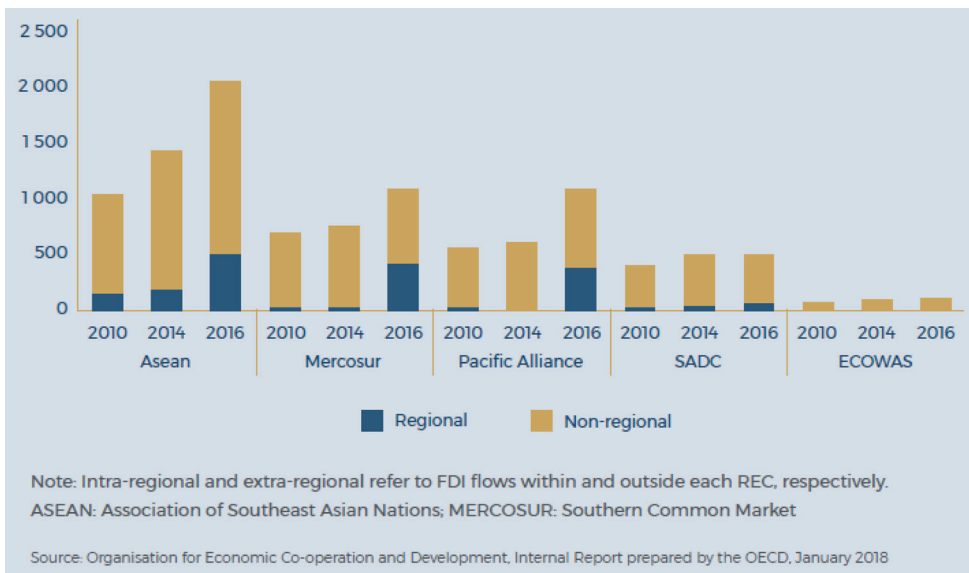


Figure 1. Inward FDI positions by REC, 2010, 2014 and 2016 (\$ billion)

3. Theories on FDI and Institutions

UNCTAD's 2006 World Investment Report (WIR) provides a conceptual framework within which FDI can be viewed. It argues that the basic rationale for FDI by firms in a global market economy is to increase or protect their profitability and/or capital value. Multinational Corporations (MNCs) engage in FDI either to gain new competitive advantages or to better exploit and safeguard the existing ones. Firms may be in a position to respond directly to the pressures or opportunities to internationalize by using their competitive advantages, some of which may be firm- or ownership-specific. The latter is necessary if internationalization is to take place through FDI and international production within a MNC system. The advantages can include assets possessed by a firm, e.g. patents, a recognized brand and production process capabilities, or more

efficient organization of the corporate assets across a geographical space. In both cases, this type of MNC strategy is referred to as “asset exploiting”, and its choice of the host country can be determined by the need to seek out new markets, raise efficiency by cost cutting, or source better quality or cheaper factor inputs, such as skilled labour, raw materials or good quality infrastructure (UNCTAD, 2006:142). In contrast to asset-exploiting MNC strategies, firms engaged in ‘asset augmenting’ strategies may not possess competitive advantages, especially the firm specific ones, and so cannot exploit them. In order to address this shortcoming, such firms may therefore be motivated to venture into international markets using their limited competitive advantages in order to acquire “strategic” assets such as technology, brands, distribution networks, R&D facilities and managerial competences.

The earlier theories of FDI mostly focused on explaining the behaviour of multinational companies, focusing on why and how they come to the decision to engage in FDI. For example, Dunning (1988) classifies the FDIs into four main categories:

- i. **Natural resource-seeking FDI** driven by the availability of natural resources in the destination country, usually in order to export;
- ii. **Market-seeking FDI** with investors willing to sell to local or regional markets, often motivated by tariff regimes in destination countries;
- iii. **Efficiency-seeking FDI** driven by competitive advantages in the destination country, such as labour costs, quality infrastructure, innovation and specialised skills; and
- iv. **Strategic asset-seeking FDI** with investors looking for an asset needed for the firm’s long-term development strategy, possibly to strengthen its position against competitors.

While the first two may appear to be purely structurally driven, local enabling policies can influence all the four types of FDI. These policies may include transportation support, beneficiation of natural resources, use of tariff structures that incentivise domestic production to access local markets, and programmes to develop specialised industry skills (Markowitz, 2020, p. 7). According to Barclay (2000, p. 18), there are four distinct theories on foreign direct investment that attempt to explain firms’ motivations for FDI: **monopolistic advantage theory**, **oligopolistic reaction theory**, **internationalisation theory** and **eclectic paradigm**. Furthermore, FDI is increasingly seen by many regional policymakers as an important source of technology transfer, industrialisation and inclusion in global production value chains.

In Africa’s earlier history, multinationals were seen as an emblem of dependency; their presence was equated with foreign exploitation and it was inconceivable that these firms could contribute anything to the development of their host economies (Mold, 2004, p. 94). However, this perception changed because of the slowdown in international commercial lending to developing countries that followed the debt crisis of the 1980s and the special role FDI is said to have played in the rapid development efforts of some East Asian economies.

FDI is also important because MNCs are often at the forefront of innovation and their presence can provide a way of keeping up with innovation and global technological progress. FDI also contributes to growth and economic development by granting firms access to new machinery and equipment through joint venture activities with foreign affiliates that possess superior technological knowledge and equipment. This can result in adopting advanced technology for the domestic use, which in turn may raise the recipient country's overall productivity (Coe et al., 1997). However, these effects of FDI on growth have not gone unchallenged by researchers and politicians. For example, FDI has been criticised for having negative employment effects, retarding home-grown technological progress and worsening the trade balance in certain countries (Moosa, 2002, p. 3). The FDI-related literature presents inconclusive results about the empirical relationship between FDI and growth. While some studies find a positive relationship between FDI and growth, others observe the opposite; still other studies conclude that FDI enhances growth only under certain conditions, such as particular levels of educational base and human capital development in the host region or country.

The role of economic and political institutions and their relationship with FDI has received considerable attention in research literature. Economic and legal institutions that determine the "rules of the game", such as law and order, control of corruption, property rights, and the way in which public services are delivered, vary considerably across countries. Numerous explanations for these differences have been put forward. An important factor is the maturity of political institutions and the effectiveness of checks and balances built by those in power; a country's geography and factor endowments, its history and structure of its society. Economic institutions can be shaped by interactions between different countries and cultures; the extent to which a country is open to trade, investment and financial flows may also be crucial. Political institutions as voluntarily followed rules, designs, and structures may stimulate change and influence the allocation of benefits and detriments for the ultimate satisfaction of all involved (Moe, 2005). The quality of political institutions is widely held to be one of the most important determinants of the quality of economic institutions (Adsera, Boix and Payne, 2003). Political competition together with checks and balances in a well-functioning democracy restrict the ability of governments to engage in rent seeking; the accountability of government to taxpayers leads to more business-friendly rules and regulations (North & Weingast, 1989). A country's geography can have a profound impact on its economic development. Landlocked countries with difficult climates and terrains may experience lower growth and development outcomes due to high transportation costs, diseases, low productivity in agriculture and other factors. Some studies argue that geography directly determines economic outcomes (see, for instance, Gallup, Sachs and Mellinger, 1999) while others maintain that geography affects development primarily through its impact on economic and political institutions (Acemoglu et al, 2005).

Both economic and political institutions are influenced by collective societal choices. In their turn, well-functioning institutions may facilitate economic growth

and investments through their influence on investment climate and business environment. (Rodrik, 2008; Acemoglu et al, 2005; Redek & Suijan, 2005). The resulting economic growth and prosperity also relies on political institutions, whose policies may serve to foster or inhibit economic growth (Acemoglu et al, 2005; Flachaire et al., 2014; Campos & Giovannoni, 2017). Failure to implement the right policy measures may lead to economic and social problems, including corruption, disregard of property rights and eventual collapse of the rule of law, and even stop the country's economic growth (Mbulawa, 2015; Campos & Giovannoni, 2017).

4. Model Specification, data and empirical framework

4.1. Model Specification and empirical studies

Exploring the impact of governance institutions on FDI in SADC, the paper drew inspiration from similar studies by Beri & Nubong (2021), Kamal et al. (2020). and Anyanwu & Yameogo (2015). It employs a panel data model to estimate the impact of institutions, while also controlling for the level of economic development, market size, investments in human capital, and the degree of trade openness. The panel econometric model can be specified as shown in equation (1).

$$FDI_{it} = \beta_0 + \beta_1 Institutions + \gamma_i X_{it} + \epsilon_{it} \quad (1)$$

Where i reflects the number of panels and t denotes the time period. FDI_{it} is the net inflow of FDI as a percentage of GDP. X_{it} is a set of control variables in the econometric model, γ_i is their corresponding parameters to be estimated. Finally, ϵ_{it} captures the idiosyncratic error terms. Several econometric models, including pooled OLS, dynamic econometric models, and instrumental variable regressions are typically employed to estimate Eq.(1). OLS provides best linear unbiased estimates under strict assumptions of stationarity, linearity, and normality. In this study, we shall estimate our econometric model using the pooled OLS technique, test for robustness with panel corrected standard errors, and the feasible generalised least squares methods. These methods fit OLS models if the idiosyncratic error terms are heteroskedastic and contemporaneously correlated. In particular, the feasible generalised least squares methods assume the error structure to be of order AR(1). Our main expectation is that institutional quality, as proxied by governance effectiveness, and economic development, market size, investment in human capital, and trade openness will play a positive and econometrically significant role in attracting FDI to the SADC member countries. We also test for this effect some other measures of institutional quality, such as regulatory quality, the rule of law, voice and accountability, political stability and control of corruption, together with the first principal components of these variables. The first principal component

was retained because it accounted for 85.38% of the variance in the institution components.

The effects of institutions and regional integration on foreign direct investment (FDI) have been tested empirically with varying outcomes. Research literature generally shows significant positive effects of formal institutions on FDI. It appears that the impacts of formal and informal institutions tend to converge; in this regard, the most important institutions are governance and regulatory institutions, institutions of civil and political rights, and also those generating corruption and political risk (Kapas, 2020, p. 163). Ajide and Raheem (2016) studied the institutions-FDI Nexus in ECOWAS countries and found that countries with better institutions were able to attract more FDI than those with poorer institutions. Bosede Adegboye et al. (2020) conducted a study on Institutional quality, foreign direct investment, and economic development in sub-Saharan Africa (SSA). Using the pooled data on 30 SSA countries for the period of 2000-2018 and panel fixed and random effect estimation techniques they found that foreign capital inflow was crucial for economic development in the SSA and the quality of institutions largely determined the size of its FDI inflows. Their study recommends that the governments of host SSA countries should find ways to boost their institutional quality to encourage further FDI inflows.

4.2. Data sources and description

The data used for this study were drawn from the World Bank's World Development indicators and the Worldwide Governance Indicators (WGI); it is balanced panel data that cover the years between 1996 and 2022. The countries chosen for econometric analysis are Botswana, Comoros, the Democratic Republic of Congo, Eswatini, Lesotho, Madagascar, Mauritius, Namibia, Seychelles, South Africa, Zambia and Zimbabwe.

The proxy for FDI is straightforward and common in the literature: it is net FDI inflows as a percentage of GDP (Beri & Nubong 2021). Proxies for institutions were drawn out of the WGI project reports which aggregates individual governance indicators for over 200 countries and territories over the period 1996–2022 in six dimensions of governance: Voice and Accountability, Political Stability and Absence of Violence or Terrorism, Government Effectiveness, Regulatory Quality, Rule of Law and Control of Corruption. These aggregate indicators express the views of a great many enterprise representatives, citizens and experts from industrial and developing countries who took part in the surveys. They are based on over 30 individual data sources produced by a variety of survey institutes, think tanks, non-governmental organizations, international organizations and private sector firms for each of the identified countries and consequently make for fairly standardized comparisons and trustworthy results. Table 2 below contains the variables used for the econometric estimations and their sources, followed by data characteristics.

Table 2. Description of Variables

Variable	Proxy/Description	Source
Foreign Direct Investment inflow	FDIi	UNCTAD Data base
Economic development	GDP per capita (GDPPC)	WDI database
Market size	Annual population growth (POPG)	
Human Capital	Education expenditure share in GDP (EDUEXP)	WDI database
Trade Openness	Trade share in GDP (Trade)	WDI data base
Voice and Accountability,	VoA	WGI data base
Political Stability and Absence of Violence/Terrorism	POS	WGI data base
Government Effectiveness,	GoE	WGI database
Regulatory Quality,	ReQ	WGI database
Rule of Law	RoL	WGI database
Control of Corruption	CoC	WGI database
Score of Principal Component	PC1	Principal Component analysis

5. Results and Discussion

Table 3 presents the descriptive statistics of all the variables in the study. It can be observed that the average FDI inflow as a percentage of GDP for the entire sample over the period considered was 4.4%. FDIi ranged from -10% (divestment in some countries) to 56.2% of GDP. Table 3 also shows summary statistics of economic development (GDPPC), market size (population growth rate), human development (EDUEXP), trade openness (XR), and governance indicators from the WGI.

Table 3. Summary statistics

	Mean	Std. Dev.	min	max	skewness
FDIi	4.443	6.812	-10.038	56.288	26.63***
GDPPC	1.547	4.343	-18.324	19.939	34.070***
POPG	1.949	1.028	-2.629	3.759	77.240***
EDUEXP	4.811	2.474	1.1	13.22	17.180***
XR	87.296	40.099	25.042	222.178	26.070***
GoE	-485	0.756	-1.841	1.15	53.86***
CoC	-.3	.711	-1.648	1.698	23.040
ReQ	-461	.738	-2.202	1.197	8.010
RoL	-419	.738	-1.918	1.024	22.270
VoA	-242	.741	-1.734	1.007	67.770
PoS	-.074	.858	-2.848	1.283	43.780
pc1	0	2.263	-5.154	3.94	-.175

Figure 2 presents a scatter plot of the relationship between FDI and our global index of institutional quality derived from the principal component analysis, together with the quadratic specification. It can be observed that there is a positive linear relationship between the two variables. The scatter plots also show that there might be evidence of heterogeneity across countries.

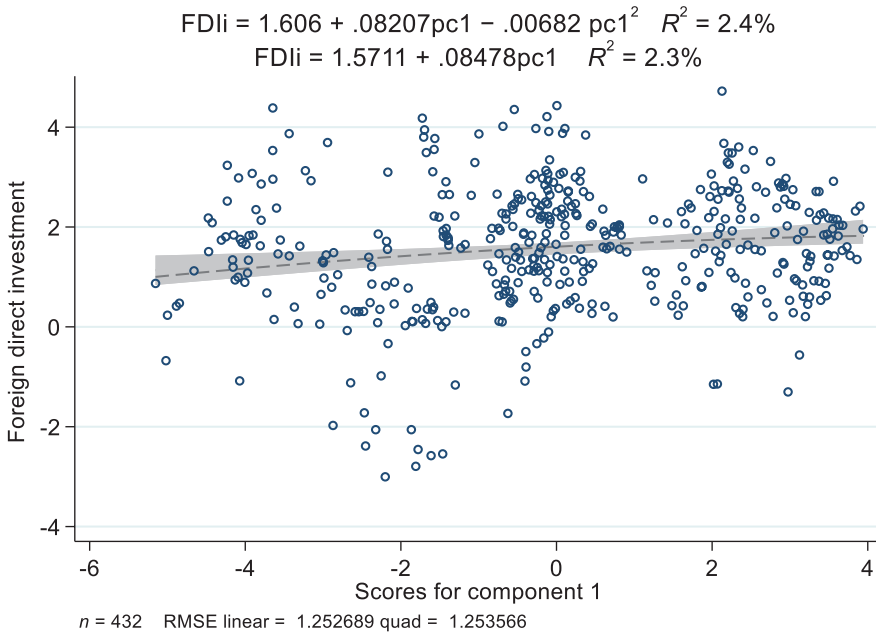


Figure 2. Scatter plot of FDI and institutional quality

We now turn over to the preliminary diagnostics of our data. Firstly, we test for normality of the data using the skewness test. Table 3 shows results of Skewness test hypothesis or the D’Agnostino-Pearson test for skewness. The null hypothesis states that the distribution is symmetric. Based on the results, we reject the null hypotheses and conclude that the distributions are asymmetric. In order to address skewness, we proceed by using sine log transformation to linearise our dataset.

In Table 4, we present results from the pair-wise correlation test of all included explanatory variables. It can be observed that the correlation between governance effectiveness and the first principal component institutional are quite high, greater than 95%, indicating evidence of potential multicollinearity. Therefore, both variables cannot be used in the same model. This is so because PC1 is derived from constructs of institutional quality, and governance effectiveness accounts for a significant variation in its construction.

Table 4. Matrix of correlations

Variables	(1)	(2)	(3)	(4)	(5)	(6)
(1) GDPPC	1.000					
(2) POPG	-0.080	1.000				
(3) EXPEDU	-0.070	-0.415	1.000			
(4) Trade	0.104	-0.406	0.336	1.000		
(6) GoE	0.045	-0.596	0.430	0.423	1.000	
(6) pc1	-0.006	-0.585	0.467	0.367	0.955	1.000

Next, we test for levels of stationarity of the variables included in our study. It is clear from Table 5 that foreign direct investment inflow, GDP per capita growth, population growth rate, trade openness, governance effectiveness, political stability and the absence of violence are stationary at level, that is, $I(0)$. The remaining variables are stationary at first difference. We therefore take first differences of human capital investment (education expenditure), control of corruption, regulatory quality, rule of law, and voice and accountability in all regressions to ensure we do not arrive at spurious regression results.

Table 5. Test for stationarity

Variable	Statistic	Level
FDI _i	-2.899***	$I(0)$
GDPC	-6.668**	$I(0)$
POPG	-6.221***	$I(0)$
EDUEXP	-7.198***	$I(1)$
XR	-1.6363*	$I(0)$
CoC	-9.405***	$I(1)$
GoE	-2.043***	$I(0)$
ReQ	-9.899***	$I(1)$
RoL	-9.309***	$I(1)$
VoA	-9.214***	$I(1)$
PoS	-2.713***	$I(0)$

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

*** $q < 0.01$, significant at 1% level, ** $q < 0.05$ significant at 5% level, * $q < 0.10$ significant at 10% level.

Note: Null hypothesis (H_0): All panels contain a unit root.

Source: Author's calculations.

The model adopted in this study follows the standard practice described in the literature on the determinants of FDI, laying emphasis on a number of variables that measure, among other things, the market size, quality of human capital, the level of economic development and trade openness as indicators of the quality of investment climate and business environment. It also uses measures of institutional quality drawn from the World Bank's governance indicators database. The results obtained from running different models within the pooled OLS (1), PCSE (2), and the FGLS (3) are presented in Table 3 below,

The determinants related to governance institutions were found to have different effects on the FDI in the region; we present results for governance effectiveness in Table 6. Accordingly, governance effectiveness has a positive and highly significant impact on FDI inflow in the SADC region. These findings are consistent with many empirical studies, such as Beri & Nubong (2023); Kamal et al. (2020) and Asiedu (2006).

Additional results in Appendix show that voice and accountability, regulatory quality, the rule of law, political stability have positive but insignificant effects on FDI in SADC. Similar relationship has been observed in the countries suffering from political instability, i.e. Zimbabwe, Swaziland, Lesotho and to some extent South Africa. Terrorist activities in the northern part of Mozambique and corruption that is still rampant in most countries of the region wield their evil influence, as revealed by the State Capture Commission and its reports in South Africa. Despite the development of judiciary systems with healthy respect for property rights and the rule of law, these challenges persist in most of the countries in the region. One may conclude that although institutional quality, business environment and investment climate are FDI-friendly, political instability, lack of security and high corruption levels remain a concern. Hence the policy implications of these findings: institutional constraints determined by the stated deleterious factors need to be addressed so that the SADC region could increase its total inflow of FDI.

According to the results obtained, economic development proxied by GDP per capita growth and market size proxied by population growth rate are significant determinants of FDI inflows into SADC. This is a confirmation of the market size hypothesis, that further attests the importance of a successful regional integration arrangement in creating a large market that attracts more FDI. The variable for human capital development proxied by the share of government expenditure on education in GDP is also positive but econometrically insignificant. The results suggest that the higher quality of human capital in the economies of the SADC region can attract FDI. The variable for trade openness is positive and highly significant in our models, which confirms the complementarity in the relationship between FDI and trade. Recent literature also suggests that FDI and trade go hand in hand as more FDI tends to encourage more trade, especially in the case of market-seeking export-oriented FDI.

Table 6. Results from Econometric Estimations

	(1)	(2)	(3)
VARIABLES	OLS	PCSE	FGLS
Economic Development	0.115** (0.0555)	0.00911 (0.0332)	0.0672* (0.0354)
Market Size	0.515*** (0.166)	0.247 (0.159)	0.783*** (0.122)
LD. Human Capital	0.327 (0.423)	0.111 (0.263)	0.0567 (0.286)
Trade Openness	0.981*** (0.176)	0.794*** (0.135)	1.281*** (0.124)
Governance Effectiveness	0.310*** (0.105)	0.382*** (0.0950)	0.227*** (0.0785)
Constant	-4.081*** (0.948)	-2.928*** (0.770)	-5.800*** (0.652)
Observations	282	282	282
Number of ids	14	14	14

Robust standard errors in parentheses

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Source: Author's calculations.

6. Conclusion

The recent unbundling of global production and other changes represent real opportunities for developing regions to become part of the global production structures. The inflows of FDI can make a significant contribution to the process through technology transfer and diffusion and capital accumulation that comes with greenfield FDI. FDI may boost economic growth and development in the recipient countries if the right kind of investment is attracted and channelled to the right sectors. The SADC region is in dire need of more FDI and its diversification into other sectors, which should help the region shift away from resource dependence and develop its industrial and manufacturing base. This paper shows that the region has made significant progress in improving its business environment and investment climate, the quality of governance and democracy institutions proxied by Voice and Accountability, Government Effectiveness, Regulatory Quality and the rule of Law. These are further supplemented by successful regional integration and good quality of human capital. More work, however, needs to be done to increase the quality of the region's infrastructure, take corruption under control and meet the challenges

brought about by political instability and surges of violence and terrorism. Should these be addressed, the SADC region will be able to increase its inflow of SADC and use it to advance its developmental objectives.

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Appendix

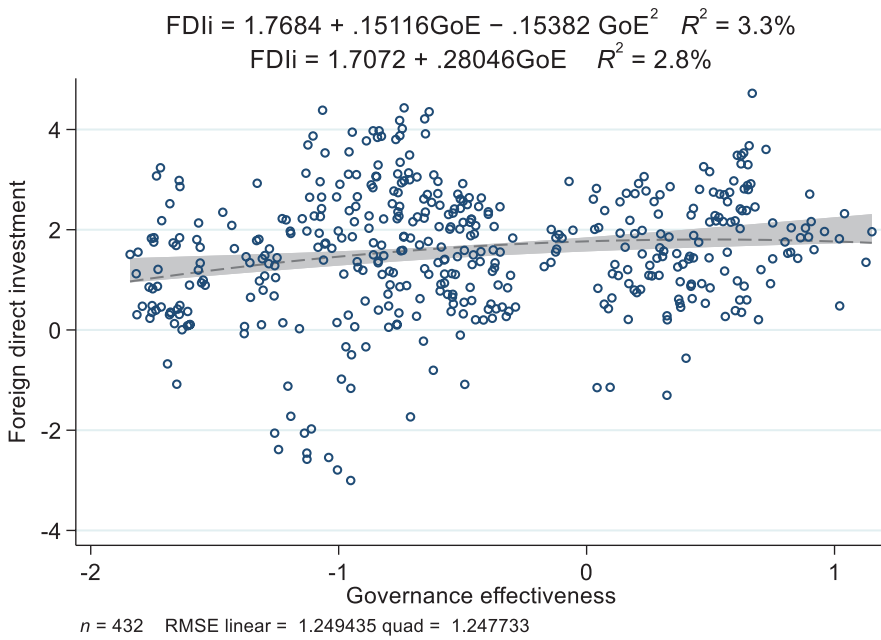


Figure AI. Scatter plot of of FDI and governance effectiveness

Table AI. Further regression results, PCSE

	(1)	(2)	(3)	(4)	(5)	(6)
	m1	m2	m3	m4	m5	m6
VARIABLES	FDI _i	FDI _i	FDI _i	FDI _i	FDI _i	FDI _i
Economic development	0.0121 (0.0339)	0.00870 (0.0336)	0.0104 (0.0339)	0.0116 (0.0341)	0.00882 (0.0346)	0.0115 (0.0341)
Market size	0.194 (0.158)	0.204 (0.157)	0.135 (0.151)	0.139 (0.153)	0.141 (0.154)	0.126 (0.154)
D. human capital	0.126 (0.269)	0.143 (0.272)	0.125 (0.275)	0.118 (0.274)	0.137 (0.276)	0.134 (0.276)
Trade openness	0.741*** (0.163)	0.811*** (0.139)	0.813*** (0.146)	0.830*** (0.142)	0.788*** (0.163)	0.845*** (0.145)
CoC	0.398** (0.185)					
ReQ		0.304***				

Table A1. Continued

	(1)	(2)	(3)	(4)	(5)	(6)
		(0.108)				
D. RoL			0.391			
			(0.560)			
D. VoA				-0.251		
				(0.370)		
PoS					0.0664	
					(0.152)	
D. Scores for component						-0.0392
						(0.203)
Constant	-2.684***	-3.038***	-3.005***	-3.117***	-2.884***	-3.151***
	(0.881)	(0.781)	(0.810)	(0.794)	(0.885)	(0.807)
Obs,	282	282	282	282	282	282
R-squared	0.154	0.144	0.128	0.123	0.129	0.131
Number of id	14	14	14	14	14	14

Standard errors in parentheses

*** p < 0.01, ** p < 0.05, * p < 0.1