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Dissertation Thesis

FISCAL POLICY IMPACTS ON PARTICULAR ECONOMIC SECTORS IN LIBYA   - CASE OF STUDY FOREIGN DIRECT INVESTMENTS

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ABSTRACT

Nowadays, foreign direct investment has increasingly become an important aspect of international trade and globalisation as direct investments by foreign investors continue to contribute significant portions of world economies. This thesis aims to investigate whether foreign direct investment in Libya as the dependent variable is significantly related to the country's fiscal policy by considering variables of the fiscal policy such as the country risk, market size (GDP), human capital, government budget surplus, government expenses and corporate income tax rates (independent variables). A simple linear regression model has been used to facilitate data analysis where the primary reason for applying this model is to succinctly investigate the type and extent of relationships existing between the dependent variable (FDI) and the independent variables in terms of the relationships' direction and strength through calculation of correlation coefficients. The SPSS Software has been used to conduct the data analysis where descriptive statistics, ANOVA analysis, correlations analysis, residual statistics, coefficients, regression statistics as well as a scatterplot and a histogram have been used for the examination of both the short-term and long-term relationship between independent variables and FDI in Libya. The study findings show that fifth hypotheses (H2, H3, H4, H6 and H7) out of the seventh hypotheses stated in beginning of the study were confirmed while two hypotheses (H1 and H5) were rejected. Both correlational analysis and regression analysis results facilitated by a simple linear regression model as well as graphical representations of the study data through scatterplots and histograms confirms the existence of significant positive or negative relationships between the FDI and CR , HC, GDP, GEX, GC and GI in Libya.

This is clearly evident that foreign direct investment (FDI) in Libya are likely to be influenced either positively or negatively by the fiscal policy parameters, and implying that fiscal policy is one of the greatest determinants of (FDI) in Libya.

Key words: Fiscal Policy, Foreign Direct Investments (FDI), Country Risk, market size (GDP), Human Capital, Government Budget Surplus, Government Expenses and Corporate Income Tax Rates, independent variables, dependent variables, data analysis and relationship.

ABSTRAKT

Přímé zahraniční investice v posledních letech nabývají na významu jak pro mezinárodní obchod, tak pro globalizaci, kdy přímé investice zahraničních investorů představují podstatnou část světové ekonomiky. Cílem této práce je určit, zda přímé zahraniční investice v Libyi (závislá proměnná) jsou významně spojeny s fiskální politikou státu.Zahrnuté (nezávislé) proměnné fiskální politiky jsou rizikovost země (country risk), velikost trhu (HDP), lidský kapitál, vyrovnanost státního rozpočtu, státní výdaje a korporátní daňové sazby. Pro určení vztahů a intenzity jejich působení mezi závislou proměnnou (FDI) a nezávislými proměnnými bylo užito jednoduchého lineárně-regresního modelu, který pomohl determinovat korelační koeficienty. Pro ověření krátkodobých a dlouhodobých vztahů mezi nezávislou proměnnou a přímými zahraničními investicemi v Libyi byl užit software SPSS a za jeho pomoci vytvořena popisná statistika, analýza ANOVA, korelační analýza, analýza reziduí, koeficientů a regrese, zatímto účelem byl dále vytvořen korelační diagram a histogram. Ze studie vyplývá, že pět (H2, H3, H4, H6 a H7) ze sedmi hypotéz uvedených v práci byly potvrzeny, zatímco zbylé dvě (H1 a H5) byly zamítnuty. Výsledky, jak korelační, tak regresní analýzy, získané pomocí jednoduchého lineárně-regresního modelu a jejich grafické znázornění pomocí korelačního diagramu a histogramu potvrzují výskyt významných pozitivních a negativních vztahů mezi přímými zahraničními investicemi a rizikovostí země, lidským kapitálem, HDP, vládními výdaji a vládními investicemi v Libyi.

Je zcela patrné, že přímé zahraniční investice v Libyi mohou být ovlivněny pozitivně i negativně fiskální politkou a jejími parametry. Tato skutečnost implikuje fakt, že fiskální politika je jedním z nejdůležitějších faktorů ovlivňujících přímé zahraniční investice v Libyi

DECLARATION

I hereby declare that this research is my own work. It is submitted in partial fulfilment of the requirements for the PhD degree at Czech University of Life Sciences Prague, Faculty of Economics and Management, Department of Economics. It has not been submitted before for any degree or examination in any other University, except where due acknowledgment has been made in the text.

Place: Prague, CzechRepublic   **Author:**Abudeltef Galalh

Date :20May 2013   **Signature:**……………………

DEDICATION

I dedicate this work to all Libyans and those interested in issues of foreign direct investment in Libya.

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First of all, praise is to Allah, the Almighty, on whom ultimately we depend for sustenance and guidance.

My sincere appreciation goes to my supervisor doc. Ing. Mansoor Maitah, PhD, whose guidance, careful reading and constructive comments were invaluable. His timely and efficient contribution helped me shape this into its final form.

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LIST OF ABBREVIATIONS

ACRS   Accelerated Cost Recovery System

BEE   Business Enabling Environment

BoP   Balance of Payments

BS   Government Budget Surplus#

CAPEX   Capital Expenditures

CR   Country Risk

CRS   Cost Recovery System

CTR   Corporate Income Tax Rate

FDI   Foreign Direct Investment

GBS   Government Budget Surplus

GC   Government Consumption

GDP   Gross Domestic Product

GEX   Government Expenses

GI   Government Investment

HC   Human Capital

IMF   International Monterey Found

IT   Investment Tax

MNC   Multinational Corporations

NTC   National Transition Council

TNCs   Transnational Corporations

UNCTAD   United Nations Conference on Trade and Development.

WB   World Bank

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CHAPTER I: GENERAL INTRODUCTION

1.1 Introduction

Over the last two or three decades, international investments across the world have tremendously increased including Foreign Direct Investment (FDI)which is an important component of international investments constituting a significant percentage of GDP for many countries worldwide. This increasing significance of FDI is attributable to the fact that it plays an essential in facilitating both economic and social development since the direct investment made by foreign investors (FDI inflows) or made by home country to foreign countries (FDI outflows) have been making crucial contribution to the respective countries' economic development as an important source of funding for economic development projects in such countries(Aitken, Hansen and Harrison,1997;Christiansen, Oman and Charlton,2003).If a country has high value of FDI inflows compared to the value of FDI outflows, then this implies that there will be a surplus of foreign currency as well as increased inflow of capital goods and production inputs which are essential drivers of a country's economic development plans(Pongsiri,2004 ; Taylor,2000).

However, the rate of FDI growth and development has been extensively influenced by fiscal policies in many countries across the world. For instance, a country's fiscal policy has been likely to either positively or negatively influence its FDI growth and development. The most obvious factors that influence FDI in a country and that are associated with fiscal policy include: country risk, market size (GDP), human capital, government budget surplus, government expenses and corporate income tax rates. Fiscal incentives mostly in the reduction of tariff and corporate tax rates have been essential in creating a favourable investment climate for foreign investors. Moreover, other fiscal incentives have also been utilised by both developed and developing countries (Libya included) in order to attract more FDI. This is attributable to the fact that, it is the goal of any country to attract significant FDI which translates to improvement in the economy performance due to expansion of the GDP.

Therefore, the crucial role played by FDI in modern economies, both developed and developing due to their considerable part of GDP for many countries worldwide, its continued importance cannot be underestimated making its political, social, and economic significance to continue increasing. However, the increasing significance and extent/value of FDI between developed and developing countries, or between developed and developed

countries, or between developing and developing countries has been greatly motivated by increasing industrialization, globalisation, outsourcing, advancing infrastructural developments particularly in the transport sector, as well as increasing number of multinational corporations. Thus, both developed and developing countries including Libya (case study country) have continued to prioritize formulation and improvement of appropriate policies or measures that directly influence foreign direct investment such as fiscal policy which is one of the most significant determinants of FDI flows in and out of a country(Akonlo, 2004 ; Alfaro and Charlton,2009).

The rise of foreign direct investmentin recent past has become inseparable from increasing foreign trade between countries across the world, and has greatly contributed improved relations between countries across the world as well as increased production levels(Ahlquist,2006; Ajayi,2006; Blomström,1986;Osman,2000). Therefore, the increasing significance of FDI due to its crucial role in economic development and the fact that any country in modern world needs other for survival, it has become a norm for all countries throughout the world to treat FDI strategies with the seriousness they deserve by making FDI plan an inevitable part of governance and economic management. For example, Libya has been in the forefront in the promotion of FDI since the discovery of oil in the year 1958, and despite the setbacks that Libya has experienced in its FDI promotion interventions since independence particularly due to economic sanctions and poor economic policies, significant FDI has been achieved in the country especially in the oil and gas sector which has become a significant contributor to the country's GDP(DeMello,1997;Gachino,2006).

However, little research has been done about Libya's FDI particularly concerning the factors that influence FDI in the country. Hence, this study aims at investigating the impact of fiscal policy on Foreign Direct Investment (FDI) in Libya. Specifically, this case study investigates the influence of fiscal policy on FDI over the last decade for duration of eleven years, that is, the period between 2000 and 2010.

1.2 The Aims and Objectives of the Study

1.2.1   Aims

The aim of this study is to evaluate the impact that fiscal policy may have on foreign direct investment (FDI) in Libya and which variablesthat would be more attractive to the MNCs in making their decision to locate FDI in a foreign economy. The other aim is determining the

capacity and effectiveness that fiscal policy in Libya had to attract foreign direct investment for the period from 2000 to 2010.

1.2.2 Objectives of the study

1.2.2.1 General Objective

1. To investigate the relationship between fiscal policy and Foreign Direct Investment (FDI) in Libya. Furthermore, to investigate which factors, fiscal or non-fiscal, contribute significantly to FDI inflow to Libya.

1.2.2.2 Specific Objectives

1. To investigate the relationship between Corporate Income Tax Rate (TR)and Foreign Direct Investment (FDI)in Libya.

2. To investigate the relationship between Country Risk (CR)and Foreign Direct Investment (FDI)in Libya.

3. To investigate the relationship between Human Capital (HC)and Foreign Direct Investment (FDI) in Libya.

4. To investigate the relationship between Market Size (GDP)and Foreign Direct Investment (FDI)in Libya.

5. To investigate relationship between Government Budget Surplus (GBS) and Foreign Direct Investment (FDI) in Libya

6. To investigate the relationship between Government Expenses (GEX)and Foreign Direct Investment (FDI) in Libya.

7. To investigate which government expense (government consumption or government investment)has significant impact on Foreign Direct Investment (FDI) in Libya.

1.3 Research questions

This study proposes to investigate the following research questions

1.3.1 General Questions

1. Which factors, fiscal or non-fiscal, contribute significantly impact on FDI inflow to Libya?

2. How could Libyan governments better employ the fiscal policy instruments to attract the FDI inflow to Libya?

3. How successful was Libya in the last decade in providing fiscal incentives in order to encourage FDI inflow?

1.3.2 Specific Questions

1. Is there a significant relationship between Country Risk (CR) and Foreign Direct Investment (FDI) in Libya?

2. Is there a significant relationship between Human Capital (HC) and Foreign Direct Investment (FDI) in Libya?

3. Is there a significant relationship between Market Size (GDP) and   Foreign Direct Investment (FDI) in Libya?

4. Is there a significant relationship between Corporate Income Tax Rate (TR) and Foreign Direct Investment (FDI) in Libya?

5. Is there a significant relationship between Government Budget Surplus (BS) and Foreign Direct Investment (FDI) in Libya?

6. Is there a significant relationship between Government Expenses (GEX) and   Foreign Direct Investment (FDI) in Libya?

7. Is there difference between the impact of government consumption and government investment on Foreign Direct Investment (FDI) in Libya?

1.4 Research hypotheses

H1: There is negative and significant relationship between Corporate Income Tax Rate (TR) and Foreign Direct Investment (FDI) in Libya. The higher the tax rate (measured by the corporate tax rate), the less attractive a host country is to the multinational firms as taxes cut directly into their profits. A negative effect is expected on the FDI. The higher the tax rate (measured by the corporate tax rate), the less attractive a host country is to the multinational firms as taxes cut directly into their profits.

H2: There is a negative and significant relationship between Country Risk (CR) and Foreign Direct Investment (FDI) in Libya. Country with high political, financial, and social risks (measured by Country Risk) tends to be unattractive to foreign investors. Conversely, a more stable country tends to attract more foreign investors than a country that is less stable. The more stable a country is, the safer it appears to capital investors. From the foregoing, country risk can be a positive sign when risk is low or negative sign when risk is high. Either effect is therefore expected on FDI depending on how investors view the host country. Every country in the world falls between the numbers 1 through 100. Number 1 indicates most risky and 100 least risky country. The closer a country is to 100, the less risky that country is considered.

H3: There is a positive and significant relationship between Human Capital (HC) and Foreign Direct Investment (FDI) in Libya. Foreign investors tend to seek out countries or regions with accumulation of Human Capital (workforce). The more educated and skilful the workforce the more attractive it is to investors. The positive effect is expected on FDI.

H4: There is a positive and significant relationship between Market Size (GDP) and Foreign Direct Investment (FDI) in Libya. The larger the market (as measured by a country's Gross Domestic Product), the greater the attraction to the MNCs that want to invest. A large market is created out of a population with high income and high purchasing power. This is where the size of the middle class is very important. The size of a nation's middle class can essentially indicate the size of the market in a host country. A large market size (GDP) is expected to have a positive effect on FDI.

H5: There is a positive and significant relationship between Government Budget Surplus (BS) and Foreign Direct Investment (FDI) in Libya. Budget surplus tend to encourage foreign

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direct investment in a host country as consistent budget surplus tend to point to fiscal discipline. A positive effect is expected on FDI.

H6: There is a negative and significant relationship between Government Expenses (GEX) and Foreign Direct Investment (FDI) in Libya.

H7: There is a significant difference between the impact of government consumption and government investment on Foreign Direct Investment (FDI) in Libya.

1.5 Study Methodology

In order to ensure that this thesis was successfully carried out, a case study research design was adopted and it was made sure that the case study was descriptive and explorative in nature. The adoption of this research design was to ensure that adequate data about foreign direct investments (FDI)and fiscal policy variables in Libya was gathered subsequent to succinct discussions and descriptions of the collected data as well as critical evaluations through data analysis in order to explicitly decipher the relationships between them. This is mainly because the adopted case study research method was used as a strategyfor empirical inquiry to enable investigation ofthe relationship betweenfiscal policy and FDI in Libya as a contemporary phenomenon of the country's economy. The case study research design adopted in this study involved collection of quantitative data as an evidence to aid hypothesis testing and making of conclusions, and it also heavily relied on variousreferences as sources of secondary data used as evidence. This secondary sources of data included relevant online databases such as the Central Bank of Libya Database, World Bank Database, IMF and UNCTAD.This was in addition to reviewing of other secondary sources of data such as books, reports, journal articles for additional information. The case study research design was an all-inclusive approach constituting the logic of study design, and techniques of data collection and analysis adopted in this study.

Considering that most of the data collected in this case study was descriptive in nature since it highlights various aspects, patterns or trends of FDI and fiscal policy variables in Libya; a descriptive research design became inevitable since only secondary data was collected thus requiring critical description and analysis in order to decipher any essential meaning in the observed patterns and trends so that relationships under investigations could be determined. The use of this research design was necessary to make sure descriptions and inferences were made concerning indicators of FDI in Libya as well as determining the extent of how FDI is

influenced by fiscal policy in the country through observed directions and strength of relationships between FDI and fiscal policy. However, since quantitative data was collected concerning FDI and fiscal policy indicators in Libya, the descriptions were also quantitative in nature. The quantitative secondary data collected in this case study was heavily relied on to provide descriptions of indicators the Libyan fiscal policy and FDI prior to subjecting the collected data to data analysis techniques for the determination of any significant relationships that exist.Furthermore, fiscal policyand FDI characteristics in Libya were also described throughdetermination of their descriptive statistics such as averages and frequencies. Thus, combination of case study and descriptive research designs was crucial in order to facilitate collection as well as description of data concerning fiscal policy and FDI indicators in Libya to allowa succinct understanding FDI and fiscal policy in Libya as well as determining the significant relationships that exist between the two.

Furthermore, in order to decipher any meaningful trends or patterns among study variables or significant relationships between study variables descriptive analytical methods and quantitative statistical analysis techniques were used to facilitate data analysis. For instance, simple linear regression model was used in establishing the relationship between fiscal policy and FDI in Libya as well as determining the influence of former on latter through the assistance of SPSS software. The study period of this case study is duration of 11 years between 2000 and 2010, and itrepresentsa period characterised by varied economic situations in Libya, especially the period preceding and followingsuspension of economic sanctions as well as restructuring of Libyan economy through liberalisation.

1.6 Structure of the Study

Following this introductory chapter which is the first one, the next chapter which becomes chapter 2 of the dissertation reviews theavailable academic literature on growth theories, FDI theory, effects of fiscal incentives on FDI, as well as Foreign Direct Investments. The literature review chapter will act as the foundation on which research questions will be based as well as outlining the way in which the identified research questions will be addressed. The fiscal policy concept, types and their relationship to monetary policy are also discussed in this chapter. Chapter 3 of the dissertation provides a descriptive overview and relevant data on the impact of fiscal policy on the investment's climate in Libya. The influence of investment climate in attracting foreign direct investment in Libya is discussed in this chapter through a theoretical framework for creation and improvement of investment climate. The relationship

between tax policy and foreign direct investment as well as the relationship between public expenditure policy and foreign direct investment are also discussed in this chapter.

On the basis of literature review, Chapter 4 discusses the role of foreign direct investment in funding economic development in the developing countries. In particular, the concept of economic development and its relation to foreign direct investment as well as local and foreign sources of financing for economic development are discussed in this chapter. Furthermore, the concept, forms and the importance of foreign direct investment in developing economies is discussed in this chapter. Chapter 5 examines the effectiveness of fiscal policy in Libya in attracting the foreign direct investment (FDI) in the period (2000 to 2010). The status of the foreign direct investment in Libya and the reality of fiscal policy in Libya particularly public spending policy, general revenue policy, and general budget in Libya are discussed in this chapter. Moreover, Chapter 5 furthers examines the effects of fiscal policy on the investment climate in Libya.

In order to enable the analysis of study results obtained from descriptive statistics of fiscal policy and FDI in Libya, Chapter 6 explains the research methods and methodology used in the study. This chapter discusses the theoretical model adopted as well as hypotheses of the study. Moreover, the study data sources and analysis techniques used are discussed in this chapter. The research methodologies utilised are both qualitative and quantitative in nature as well as consisting of the study econometric model (linear regression model) and a case study of Libya for the period from 2000 to 2010. Chapter 7 provides the analysis of the study results, and discussion of the research results or findings. In this chapter, more focus is concentrated on the analysis of the results of findings obtained from the case study on the basis of the proposed econometric model with the help used analysis techniques. Furthermore, the chapter also provides the discussion of the case study results or findings.

Finally, Chapter 9provides a summary of the study's overall findings or results, conclusions and limitations. Also the recommendations as well as the implications of the research findings for policymakers and companies are summarised in this chapter.

CHAPTER II: THE THEORETICAL FRAMEWORK OF THE STUDY

2.1 Literature Review

2.1.1 Growth Theories

Growth theories mainly attempt to provide an explanation to the conditions that are necessary for a country's growth and development to occur, as well as weighing up the relative importance of conditions that are particular for growth and development in various countries(Balasubramanyam, Salisu and Sapsford,1996 ; Riley,2006).Early growth theories put more emphasis to understand economic growth, by attempting to find general growth determinants that were applicable to any instance that was considered(Ahlquist,2006 ; Alfaro, Kalemli and Sayek,2004). However, upon looking at growth patterns the focus was diverted at discovering some principles or laws which govern growth in all countries and at all times(Charlie,2007 ; Creswell,2003). Therefore, various modern growth theories have already been developed which generally acknowledge the fact that that growth conditions change over time(Gachino,2006 ; Konings,2001 ; Ragazzi,1973). Thus, over the years, economists drawn from distinct schools of thought have held varied opinions and ideas in regards to what really drives growth in a country, and particularly economic growth. These ideas and opinions have been packaged into theories generally referred to as growth theories. These theories provide an elaborate explanation of why there is varied economic growth and development in various countries and at different times, particularly focusing on the importance of supply-side factors (mostly attributed to FDI) as determinants of the trend rate of growth for different countries that compete in the global economy. Such theories include:

2.1.1.1 Trend/linear growth theory

In this theory growth in economy is defined as an expansion that is long-term in the potential of a country's economy to be productive(Creswell, 2003 ; Gachino, 2006). Trend growth theory is also referred to as linear growth theory and it refers to the smooth path of national output that is long-run. Therefore, long-run macroeconomic data (probably over two decades or more is required to measure the trend rate of growth in a country in order to ensure different stages of a country's economic cycle are identified for the facilitation of the calculation of average growth rates from trough to trough or peak to peak(Konings,2001 ; Ragazzi,1973).

This implies that another way to think about the trend/linear growth theory is to view it as an economy's speed limit that is underlying. In other words, this theory is an estimate of the rate at which the growth in a country can realistically be envisaged to occur over several years without inflationary pressures increase that are unsustainable being created. Furthermore, it has also been observed that many factors work together in a collaborative manner to influence the rate of growth. Such factors includethose with temporary effect and those with long-term effect (Alfaro,Chanda and Kalemli,2004). For instance, changes in business and consumer confidence, aggregate demand, as well as fiscal and monetary policy, usually have temporary effect on growth. However, there are other factors which have more enduring effects on the rate of growth such as productivity growth and the rates of population, both of which tend to influence growth rate in a country over long periods of time(Charlie,2007 &Creswell,2003 and Ragazzi,1973). Most of developing countries including Libya which is considered in this study are typically low to middle-income countries and their growth potentials are fairly strong because they tend to experience rising incomes as a result of high levels of inward investment (contributed by foreign direct investment),(Gachino,2006 &Konings,2001). This phenomenon is illustrated in Figure 1 below which outlines an estimate of the predicted growth path for the economy of a country(Gachino,2006 &Konings,2001).

Figure 1: Growth trend of low to middle-income countries whose growth potential is fairly strong
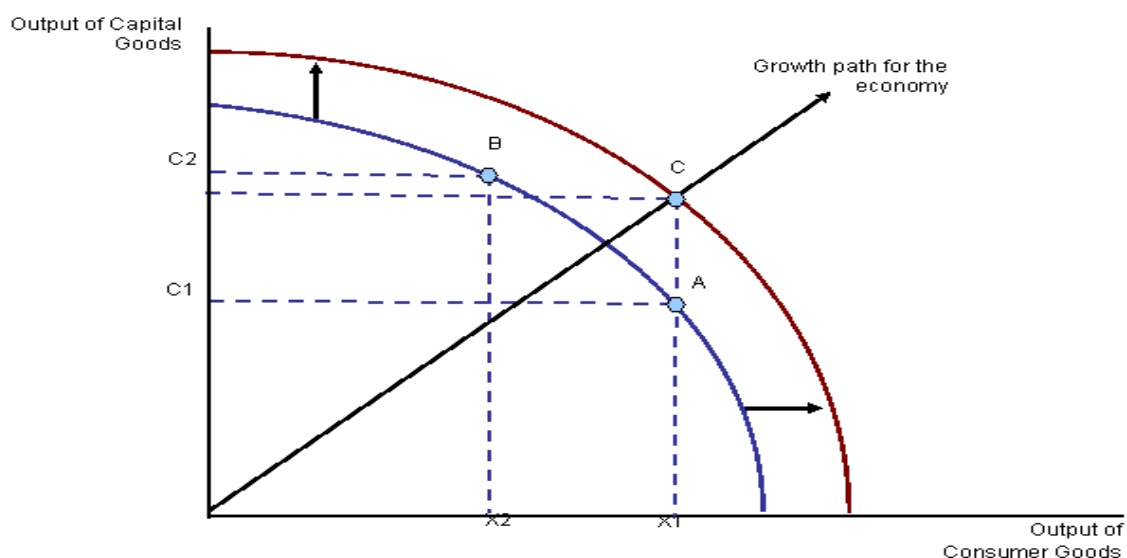
Source: Riley, G. (2006)

Increased levels of long run aggregate supply (LRAS)have different effects that can be traced in Figure 2 below. Increase LRAS levels allow the economy of a country to operate at an aggregate demand of higher levels leading to increased real national output that is sustained. This phenomenon is clearly outlined in Figure 2 below.

Figure 2: Effects of an increase in long run aggregate supply (LRAS)
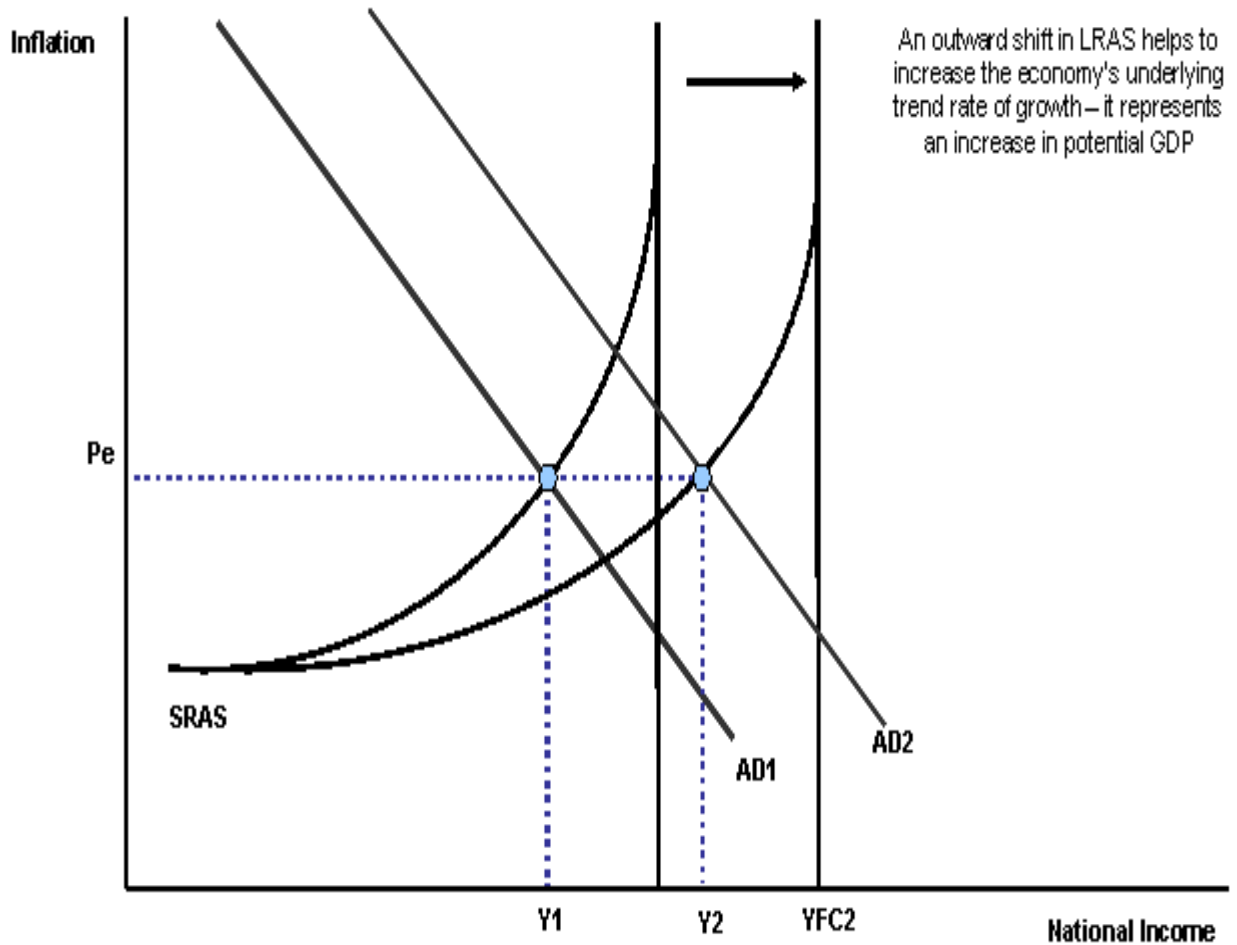
Source: Riley, G. (2006)

2.1.1.2 The neoclassical growth theory

The notion of growth as an increase in means of production (stocks of capital goods) was codified in the middle of last century to show the relationship between capital goods, labour-time, output and investment (both domestic and foreign). From this perspective, the role of technological change as a determinant of growth in a country became important, even more crucial than the capital accumulation (Riley, 2006). Robert Solow and Trevor Swan were the pioneers of the development of this model in the 1950s, as a result of their attempts to analytically model long-run growth in a country. The general assumption in this theory is that countries effectively use their resources and the returns to capital are diminishing whilst labour increases. This implies that these two premises of this theory necessitate three important predictions to be made. First, economic growth is created by increased capital relative to labour, since given more capital it is possible for people to be more productive. Second, there will be faster growth in developing countries that are poor and with less capital per person because there will be production of higher return for each investment in capital compared to developed countries that are rich and with ample capital characterized by low return in capital investment. Third, as a result of continued diminish in returns to capital, economies across the world will ultimately reach a steady state where economic growth will no longer be created irrespective of any increase in capital investment(Ayanwale, 2007 ; Balasubramanyam, Salisu and Sapsford, 1996 ; Riley,2006).

Moreover, this theory notes that it is possible for a country to overcome the steady state and begin experience a continued growth as a result of inventing new technology which revolutionises the means of production. In the long run, the rate of saving is undoubtedly the main determinant of output per capital, thus at this point thegrowth rate of the output in a country is equivalent to the saving rate. In this theory, "exogenous" is the process by which growth in countries continues irrespective of the diminishing returns in capital investment and it is characterized by the creation of new technology thereby continuing to allow higher output with fewer resources due to adoption of efficient means of production. This is mainly attributable to the fact that technology improves as well as ensuring steady state increase in the levels of capital are maintained implying that the country continues to invest and grow.

However, this theory has been criticized for lack of validity because data does not support some of its predictions, particularly, that in the long-run all countries grow at a rate that is the

same, or that faster growth should be experienced in poorer countries until they reach the steady state(Riley,2006).

2.1.1.3 Salter cycle theory

According this theory, growth in economy of a country is enabled by its increases in productivity, which leads to lowered inputs (such as the capital, material, labour, energy, etc.) for the production of a given amount of product (output). The increased efficiency in production leads to lowered cost of products thereby increasing their demand, which results to increased capacity due continued increase in capital investment(Balasubramanyam, Salisu and Sapsford, 1996). However, the efficiency of new capacity is mainly attributed to improved methods, new technology and economies of scale. This leads to further reductions in product prices, which further leads to increased demand for the produced products, until diminishing marginal utility results to the saturation of the markets(Ayanwale, 2007 ; Riley, 2006).

2.1.1.4 Endogenous growth theory

This growth theory developed as a result of criticisms to the neoclassical growth theory. Thus, the work of Paul Romer and Robert Lucas, Jr. towards the end of 1980s and at the beginning of 1990s led to an advancement of the growth theories. These economists developed the endogenous growth theory because they were unsatisfied with the neoclassical growth theory explanation(Balasubramanyam, Salisu and Sapsford, 1996 ;Ayanwale, 2007). This theory worked towards "endogenizing" technology by providing explanation of technological advancement in a mathematical way.A new concept of human capital was incorporated in this theory, the knowledge and skills that make workers productive. However, unlike physical capital, increasing rates of return are observed in human capital. Thus, in overall constant returns to capital are observed indicating that the growth of such economies or countries never reaches a steady state. Moreover, as capital accumulates growth does not slow, but the growth rate is highly dependent on the types of capital in which investments are directed by a country(Riley,2006). Furthermore, more focus in this theory has been directed to factors that increase technological change (e.g. innovation) or human capital (e.g. education).

2.1.1.5 Energy and energy efficiency theory

The role of energy on growth has been extensively evaluated over a considerable period of time and the importance of energy and energy efficiency to economic growth has been determined. Thus, the importance of energy to growth of a country's economy has been recognized by people in many and varied professions such as economists, economic historians, engineering, prominent businessmen,government agencies as well as various technical and science organizations. This is attributable to the fact that there is a strong correlation between gross national product and energy use.

All approaches to energy inclusion into the growth theory do not have a complete and accurate formulation, but its role in describing growth of a country's economy cannot be overlooked or underestimated. This is mainly because the pioneers and great proponents of this theory aimed at addressing the deficiencies in the endogenous and neo-classical growth theories (Balasubramanyam, Salisu and Sapsford, 1996 ; Riley,2006). It posits that chemical and physical work that energy performs is very important; hence, historically energy has been a significant driver of economic growth.Therefore, the proponents of the energy growth theory criticizethose who neglect the role played by energy as well as natural resources as a determinant of the rate of a country's economy growth(Riley,2006). For instance, this theory relates slow rates of economic growth to inefficiencies in energy conversion, and notes that energy has been a major contributor of economic growth over a long period of time(Ayanwale, 2007).

2.1.1.6 The big push

The other theory that explains economic growth, mechanisms that allow it to take place as well as its main determinants is the big push developed in the 1940s, which suggested that a virtuous cycle is the path followed by countries as they jump from one development stage to another which is a necessity, but requiring large investments in education and infrastructure in combination with private investments(Riley,2006). This theory suggested that if these factors are amicably coupled and effectively implemented they would result to growth in an economy by movingit to a more productive stage, a phenomenon attributed to the fact that a country has broken free from paradigms associated to its previous stage of lower productivity(Ayanwale, 2007; Balasubramanyam, Salisu and Sapsford,1996).

2.1.2 FDI Theory

Foreign Direct Investment (FDI) has over time acquired a significant role in the international economy especially among the developing countries (Alfaro and Charlton,2009). Thus, numerous theoretical studies have been conducted on FDI leading to a better understanding of the mechanisms of international economic and the mechanismsof allowing the opening of new markets (Ayanwale,2007). Therefore, nowadays more attention is given to the issue of foreign direct investments (FDI), and various theories exist that explain and critically examine this phenomenon of foreigndirect investment (FDI) an element believed by many economists to have significant impact on economic development and growth in all countries across the world, more specifically in the developing countries. However, FDI has so far been succinctly determined to have significant influence on economic growth and development despite the fact that the effects of FDI are complex. For instance, from a macro standpoint FDI is often considered to be a generator of employment, technology spillovers, competiveness andhigh productivity (OECD,2007 ;Brewer, 1993).In particular, for developing countries,FDI is often believed to translate to higher exports, access to international currencies and international markets, as an important source of financing to the country.

Evidence exists supporting that FDI promoteseconomic growth and development and fiscal policy is believed to significantly influence it. Thus, it is considered that the efforts made by many countries across the world, especially the developed ones in attracting FDI are mainly because of the potential positive effects likely to be caused on their respective economies. For example, several studies have linked FDI to increased productivity, managerial skills, technology transfer, knowhow,reducing unemployment, international production networks, as well asfacilitating access to externalmarkets(Ragazzi,1973).These ideas have been supported by many researchers and businessmen in both developed and developing countries considering that FDI is the main way through which technology spillovers can be achieved, leading to greater contributionsto growth and development of the economy than national investments would achieve. However, FDI may lead to the crowding out of local enterprises thereby negatively impacting oneconomic development. Moreover, the potential positive or negative effects of FDI on the economy of a country may also be particularly dependent on the nature of the sector of the economy in which investment has taken place(Bowles,2004 ; Buckley and Casson,1976 ; Ragazzi,1973).

Multinational corporations control a significant portion of foreign direct investments (FDIs), and when multinational corporations enter foreign markets in different countries worldwide where they take advantage in those markets(Ayanwale, 2007). Moreover, the superior technology and knowledge of foreign investors in developing countries who own most of multinational corporations is consideredto have the potential of giving them a chance to obtain marketshare(Ragazzi,1973). However, irrespective of the fact that the phenomenon of FDI has been explained by many researchers, it can be said that no FDI theory that is generally accepted but it is generally agreed that in a perfect competition characterized world, there would not be existence of foreigndirect investment(Alfaro and Charlton,2009). This implies that, if markets work effectively across the world meaning no barriers exist in terms of competition or trade, FDI would not play any role in participation to the international market and international trade would be the only way to achieve this (OECD,2007 ; Ayanwale, 2007).

In the period immediately afterthe Second World War, international production was very little and it contributed to a very small part of international affairs, and the attention had been greatly directed to the components such as international trade. However, since the 1960swhen thephenomenon of FDIgained momentum and began to shape the international trade and since then it has continued to gain significance in modern economies and the international market. Various theories exist that explain the phenomenon of FDI and today FDI is a considerably understood component of international trade as a result of these theories. For instance, theory of comparative advantage by Ricardo was the first attempt towards explaining FDI, but on the basis of today's market conditions FDI can't be sufficiently explained through this theory, since it is grounded on two countries, two products as well as a mobility of factors that is perfect at local level(Riley,2006 ; Ayanwale,2007). That model couldn't even allow FDI. Thus, after the failure of Ricardo's theory of comparative advantage to explain the increasing share and importance of FDI, other theories were developed such as portfolio theory. However, this theory wasdesigned to fail, since it put more emphasis on explaining the foreign investments achievement in aportfolio, but couldn't provide an explanation to the direct investments(Riley,2006) . Moreover, although more new and realistic theories of international trade formulated on basis of comparative advantage such as internalisation theory have not been able to sufficiently explain the

complexity associated with FDI, there are some FDI theories which capture FDI phenomenon to a greater extent and they may be broadly classified under the following headings:

2.1.2.1 Production Cycle Theory of Vernon

This theory was developed in 1966 by Vernon and was to a larger extent used to explain certain typesof FDI that companies from the U.S. had made in Western Europe particularly in the manufacturing industry after the SecondWorld War. According to this theory Vernon believes that four stages are involved in the production cycle which should follow each other in a subsequent manner including innovation, growth, maturity as well as a stage of gradual decline (Gachino,2006 ; Clark,2000 ; Konings,2001 ; Charlie,2007; Creswell,2003). This theory reiterates that, the first stage involves creation of new innovative products meant for the local market while the surplus is exported in order to ensure that foreign markets are also served. This theory is used to explain FDI carried out by U.S. companies in Europe after Second World War where according to this theory, after the Second World War the demand for manufactured products (comparable to those produced in USA) in Europe hadtremendously increased making American firms to begin exportation where they claimed a significant share of the market in comparison to their international competitors since they had the advantage of technology(Ragazzi,1973).

Thus, according to this theory possession of new technologies is what manufacturers take advantage of in the first stage of the production cycle. This ensures that the company acquires tremendous and steady growth in the new market eventually reaching a maturity stage. However, as the development of the new productscontinues to unfold the unique technology used by the foreign companies becomes known to other companies where they export their products(Anyanwu,1998 ; Bowles,2004 ;Ragazzi,1973). Therefore, despite the attempts by manufacturers standardize their products; some companies will just copy it. This starts to limit exportation by foreign companies to the countries where they initially dominated the market thereby forcing them to locally perform the production of their products on the local markets of such countries in order to continue maintaining their market shares. Hence, the set up of production facilities in the multinational corporations in their foreign markets translates to FDI. This theory to a larger extent managed to explain FDI's made by U.S. companies in Europe Western between 1950 and 1970 even though thereare some areas where U.S.

companies didn't possess technological advantage and FDI's were also made(Anyanwu,1998 ; Bowles,2004).

2.1.2.2 The Theory of Exchange Rates on Imperfect Capital Markets

This is the other theory that was developed in order to explain FDI. This is mainly because the perspective of international trade has been initially used to analyse risk of foreign exchange. Therefore, analysis of the influence of uncertainty in currency exchange rates as a factor of FDI has shown that an increase in real exchange rate stimulates FDImade by some multinational corporations from developed countries, while an appreciation of the foreign currency leads to a reduction in FDI made by these companies(Anyanwu,1998 ; Bowles,2004 ;Ragazzi,1973).However, this theory has not managed to explain simultaneous FDI between countries whose currencies are different even though it is argued that such FDI's are made in different times, but contradictions to these claims are imminent(Ragazzi,1973)

2.1.2.3 Neoclassical theory

This theory has also been used to explain FDI and it assumes that markets are perfectly competitive as a result leading to gains from international trade due to internationalspecialization. This theory states that scarcity of labour and its cost which is relatively high in developed countries, has made many companies in those countries to transfer productionfacilities to countries that are less developed and labour-intensive where labour is relatively cheap(Ragazzi,1973). Consequently, this has led to a unidirectional flow of capitol, that is, from countries which are developed to the capital-scarce ones. However, criticism has been directed to this theory by researchers pointing its inability to explain FDI and lack of realism. This is mainly because neoclassical theory has not been sufficiently used to succinctly explain FDI in the transition and developing countries where perfect competitive market does not exist, and the development of the basic market tools and institutions is yet to be done(Ragazzi,1973; Bowles, 2004). However, the assumption of this theory that capital flows from developed countries to the countries that are capital-scarce has played a significant role in facilitatingan understanding of the FDI incentives that are present in transition and developing economies.

2.1.2.4 Monopolistic Advantage Theory

This is another theory that has been used to explain the phenomenon of FDI in international markets where a microeconomic analysis of multinational corporations (MNCs) is carried out on the basis of industrial organization theory(Ragazzi,1973). This theory relates FDI to the motives of MNCs towards extending their production activities abroad as well as transferring intermediate products such as technology and knowledge over the world. This FDI theory argues that MNCs exist in a market that is imperfect hence this led to the introduction of differential advantages of nonfinancialMNCs in comparison to other MNCs(Ragazzi,1973 ; Ayanwale,2007).Various important production factors for transition economies are highlighted in this theory such as product differentiation, information asymmetry, new technology or patents,managerial expertise, government intervention, business ethics and culture differences.These factors give some companies a competitiveness edge in the international market leading to FDI in markets where monopolistic advantage is enjoyed as a result of the benefits of these production factors(Anyanwu,1998 ; Bowles,2004 ;Ragazzi,1973).

2.1.2.5 Substitute Theory of FDI

This theory provides an explicit explanation to FDI and it argues that when there is a deterrence of commodity movements by high trade barriers, the best option is to substitute the commodity movements with transfer of production factors. This implies that when FDI from one country to another increase there will be a reduction in exports between these countries(Ragazzi,1973). Thus, this theory posits that a perfect substitute for exports is capitalmovements that ensue as a result of FDI, if the trace of a particular is always followed by the FDI flows mainly because of lower or efficiency in costs of production factors. In line with this theory, it is argued that FDI can serve as a substitute or complement for trade on the basis of production factor where FDI could alter the composition of labour and capital in a particular sector of an economy through different channels(Anyanwu,1998 ; Bowles,2004 ; Ragazzi,1973). Moreover, according to this theory FDI can lead to increasedlevels of intermediate goods' trade used in production meaning that many MNCs invest in the transition economy countries where the output is exported to third countries.

2.1.2.6 Complement Theory of FDI

This theory was developed by Kojima in the late 1970s where Kojima argued that the origin of FDI is mainly the comparative disadvantage experienced by industries at homecountry, which on the other hand are the industries with potential comparative advantagesat the host country, a situation that is mostly dependent onthe different economic development stages specific to host and home countries(Ragazzi,1973). This theory predictsthat FDI which is export-oriented mainly occurs when there is investment in those industries at home country in which the hostcountry has a comparative advantage. Thus, from this perspective FDI is regarded as the transfer of production functions that are superiors to the host country in order to replace the inferior ones.Hence export-orientedFDI is considered to be trade creating and welfare improving since it is often associated with promotion of exports in both host and home countries(Ragazzi,1973 ; Ayanwale,2007 ; Alfaro and Charlton,2009).

2.1.2.7 The Theory of Internalization of FDI (OLI Paradigm)

This theory was proposed and developed by Dunning which argues that in order for transactions to occur within an institution, the costs of such transactionsare higher on the free market than the internal costs through a process known as internalization. In the attempts of providing a succinct explanation of FDI using this concept, the eclectic OLI paradigm was developed from the internalization theory(Alfaro,Charlton,2009 ; Ayanwale,2007). The eclectic OLI paradigm frameworks include both microeconomic ownership advantages and macroeconomic location advantages, since if taken separately they are incomplete(Ragazzi,1973). According to the eclectic OLI paradigm developed by Dunning, apart from organizational structure the importance of the advantages of three factors such as ownership,location, and internalization is of significant essence(Ragazzi,1973).

According to Dunning, different patterns of FDI in this theory are distinguished on the basis of five levels of a country's economic development. From the perspective of this theory, structureof resources, government policies and market size are the factors which determine FDI location in a host country implying that FDI patterns are not constant but vary on basis of these determinants(Ragazzi,1973). The human nature is also taken into account in this paradigm as an element that motivates FDI decisions made by MNCs. Hence, it can be stated that this theory can directly or indirectly form the theoretical basis of explaining why many

MNCs carry out FDI in transition and developing economies worldwide.(Ragazzi,1973 ; Anyanwu, 1998 ; Bowles,2004).

2.1.2.8 The Theory of Traditional Multinational Activity

This theory proposed three approaches to FDI such as vertical FDI model, horizontal FDI model, andthe knowledge-capital model. The vertical FDI model provides a description of how the production process is geographically fragmented into stages by FDI, and thehorizontal FDI model reiterates that FDI leads to production of the same services and goods in different locations(Alfaro and Charlton,2009). Both vertical and horizontal models of this theory highlight variables such as development and research across plants, market size, factor endowments, plant-level scale economies and transport costs, including cultural and geographical distance costsas well as other trade barriers involved between host country and home country(Ayanwale,2007 ; OECD,2007) . Invertical FDI theory, FDI possibly reverses trade in terms of asymmetries of factor endowmentsbetween host country and home country, and the asymmetries between countries also make it possiblefor trade and FDI to coexist(Ragazzi,1973).

In horizontal FDI model, the interacting countries are assumed to be identical in terms of preferences, technologies, and factor endowments while in vertical FDI model trade is reversed by FDI in terms of factor endowments asymmetries between home country and host country. Thus, according to these two approaches motivation of FDI flows can be caused by high productivity, resource endowments, lower labour costs, and favourable business environments(Ragazzi,1973). The third approach which is the knowledge-capital model was developed as a result of integration of both vertical and horizontal approaches and accounts for a much wider set of FDI patterns since there is a little divergence of FDI in transition countriesfrom the normal patterns(OECD,2007 ; Ayanwale,2007 ; Alfaro and Charlton,2009).The modes of entry used by MNCs to enter into transition and developing economies are attributable to the different and varied patterns of FDI formed, and the evolution of FDI patterns is a reflection of changes in both external and internalconditions.

2.1.2.9 The Resource-Based Theory

This theory was proposed and developed by Behrman in 1972 as a typology of FDI to summarize multiple MNCs' incentives. According to this theory FDIs carried out by MNCs are driven by the motivation to achieve any of the four types of results such as resources, efficiency, markets, as well as strategic assets(Ragazzi,1973 ; Bowles,2004 ; Anyanwu,1998). This theory creates a methodical basis for FDI as a strategy towards achieving competitive advantage due succinct understanding of internal and external forces that have strong influence on an organization. Thus, according to this theory FDIs carried out by MNCs are carried out by the aim to possess scarce or rare resources that are limited and unique in order to ensure that they achieve sustainable competitive advantage over their competitors as a result of good performance indicators. Accordingly, this theory also argues that MNCs must embark on the process of looking for unique attributes that have the potential of providing superiorperformance. Thus, this theory puts more emphasis on the advantages that are directly related to the complexity of managing multiple functions and activities in a global economy that is volatile, butinnovatory(Talviand Végh, 2005 ; Wells, 1972).

2.1.2.10 The Business Network Theory

This theory is developed on the basis of a set of relationships that exist between firms such as long-term buyer-supplier partnerships, joint ventures, strategic alliances, and collaborative relationships and this theory also encompass brand image and reputation of an organization as part of the network(Anyanwu,1998 ; Ayanwale,2007 ; Balasubramanyam, Salisu and Sapsford,1996 ; Faeth,2009 ; Ragazzi,1973).

Therefore, considering that the conceptualisation of the system of MNC is most frequently regarded as an inter-organizationalnetwork that is differentiated, and then it is assumed that there is a significant difference between the position of MNCs affiliates, performing their production operations in developed economies compared to that of affiliates doing production operations in transition or developing economies. However, the business networks or relationships through joint ventures, strategic alliances, and collaborative relationships have been very important in promoting FDIs in transition and developing economies. However, the differencespresent in business affiliates in terms of business experience, political and business conditions,management competences diverse risks, and workforce skills are attributable to differential FDI carried out by MNCs. Therefore, MNCs establish business

networks through joint ventures, strategic alliances, and collaborative relationships which facilitate creation andtransfer of knowledge between two different companies of between a company headquarters and the affiliates whose operations are based in transition or developing countries.

2.1.2.11 The Theory of New Economic Geography

According to this theory the interpretation of agglomeration on the basis of "home market effect" is that, it is the outcome of the interactions between factor price differences, trade costs and increasing returns. For instance, if economies of scale play a significant role in shaping trade as argued in this theory, then the economic regions that have the greatest potential of delivering the most production will also tend to be highly profitable thereby attracting evenmore FDI(Ragazzi,1973 ; Anyanwu,1998). This implies that instead of MNCs spreading out FDIs around the world in an even manner, In other words, instead of spreading out evenly around the world, FDIs will tend to be concentrated in a few regions, countries, or cities, where production operations are most economical and there is ready market. Thus, large market size, availability of resources and labour as well as high levels of business infrastructure areimportant factors that promote inward flow of FDI. This has been attributable to differential distribution of FDI around the world, and aggregate profits achievableby a foreign investor in a certain region are robustly related to differential distribution of FDI (Ragazzi,1973 ; Bowles,2004).

2.1.2.12 Diversified FDI and Risk Diversification Model

This theory has been very crucial in explaining FDI diversification as well as the role of risk factors in determining FDI patterns as well as MNCs' incentives to expand their FDIs. The importance of diversified FDI is growing because its occurrence is mainly motivated by the desire of MNCs to spread out investment risk(Ragazzi,1973; Bowles,2004 ;Anyanwu,1998). Therefore, this theory argues that firms' risk aversion, which in the past had been given low priority among the factors of FDI, is nowadays graduallyemerging to be one of the major determinants of FDI since very few FDIs are reported in high-risk business environments, regions or countries compared to those with low risk. Hence MNCs that diversify, differentiate and segment FDI on the basis of identified risk factors have managed to achieve better performance throughout (Ragazzi,1973).

However, all MNCs are usually not identical in terms of risk aversion. Thus, there is an inverse relationship between the likelihood of FDI in a particular country and the degree of a prospective investor's risk aversion. When long-term investors whose main characteristic is high risk aversion are considered, the value of the envisaged utility as a result of future profits is in most cases too small, but for risk-loving or less risk aversionfirms it could be satisfactory since they focus more on speculative transactions(Ragazzi,1973; Anyanwu,1998). Hence, selective FDI by investors may be caused by unstable economicsituations.Moreover, diversification of FDI exists in two forms such as in product and in location, and a combination of both is referred as 'double diversification'. Therefore, the phenomenon of double diversification is becoming very common among MNCs emerging in transition countries meaning FDIs by these MNCs are diversified in terms products produced and geographical localisation(Ragazzi,1973 ; Bowles,2004 ; Anyanwu,1998). This has led to rising emergence of conglomerates, also termed as highly diversified DFI because most of the transition and developing or emerging markets are characterised by high-risks.

2.1.3 Determinants of Foreign Direct Investments

There are the fiscal and non-fiscal factors that mostly attract foreign direct investments. Most theoretical models and empirical results indicate several independent variables to be very important FDI determinants in both developed and developing countries. The following section reviews the independent variables that this study considers to be most applicable.

2.1.3.1 Market Size

The market size (measured by GDP) is considered to be one of the most important independent variables influencing the decision of MNCs to locate in a country (Akcay, 2001; Aristotelous ; Fountas, 1996; Chakrabarti, 2001; Dees, 1998; Gonzalez-Vigil, 2001; Kuemmerle, 1999; List, 2001; Love ; Lage-Hidalgo, 2000 ; Tsai, 1994).

For instant ,(Akhtar, 2001) see the market growth not as significant in his studies as market size, but others consider both size and growth to be important FDI determinants (Bardesi, Davies and Ozawa 1997; Mold, 2001). The size and structure of the domestic market in relation to the growth prospects of the host country not only affect the decision on cost-minimizing plant location, they play a role when foreign firms decide to engage in export-bound production activities in the host country (De Mello, 1997, p. 5).

2.1.3.2   Human Capital

According to Luiz (1997) points to the economy with the greater endowment of human capital (measured by enrollments in primary institutions of learning) as having the tendency to provide the economic environment for the globalization of production. The analysis made within a new growth theory framework of the role of FDI in promoting economic growth shows the interactions between FDI and human capital have important influence on economic growth performance (Balasubramanyam, 1999).

Improved education, and thereby human capital conditions, is one of the country-specific characteristics necessary for FDI growth-enhancement (Asafu-Adjaye, 2000; Yang, 1999; Zhang, 2001). Human capital may affect the geographical distribution of FDI (Noorbakhsh, Paloni, and Youssef, 2001), but the higher productivity of FDI holds only when the host country has a minimum threshold stock of human capital (Borensztein, 1998).

The adjunct to human capital is the average wage of labor in the economy. On the one hand, high wages without high productivity tend to discourage FDI because wages are part of production costs. On the other hand, FDI is attracted to where high productivity and high wages co-exist because that usually suggests a reservoir of skilled labor at that location (e.g., Silicon Valley). Consequently, a country's rising wages or falling productivity encourages FDI outflows and discourages inflows (Cushman, 1987). The poor employment performance in South Africa blamed on political factors had discouraged FDI inflows into that country's economy, especially in the manufacturing sector (Kaplinsky, 1995).

Growth in FDI is positively correlated with the relative demand for skilled labor, for FDI can raise relative wages of skilled labor in a host country by bringing in skill-biased technology (Zhao, 2001).

2.1.3.3   Country Risks

Country risks (sometimes assumed to be political risks) actually refer to uncertainties related to cross-border transactions (Meldrum, 1999). They can be of different kinds and forms: political risk, exchange risk, economic risk, financial risk, investment risks, etc.

Country risks figures (measured as a composite figure from a combination of all the various risks mentioned above) can be obtained from a number of sources, prominent among them being Standard and Poor's, Euromoney Indexes, and International Country Risk Guide. By far the most popular measure is the International Country Risk Guide figure (used in this study). The Country Risk Guide composite figure is interpreted this way: every country in the world falls between the numbers 1 through 100. Number 1 indicates most risky and 100 least risky country. The closer a country is to 100, the less risky that country is considered. Country risk is one of the main FDI determinants in the studies done by (Meldrum, 1999 ; Ramcharran, 1999 ; Shah and Slemrod, 1991).

2.1.3.4   Tax Rate

The result of research on tax incentives (measured by marginal tax rate) as major determinants of FDI has been mixed. Many have argued that tax incentives are important in the FDI decisions (Akcay, 2001; Hines and Rice, 1994; Hines, 1996). For example, one study on the effects of tax policy on the international location of investment shows that tax policies such as Accelerated Cost Recovery System (ACRS) and the Investment Tax Credit (ITC), which are more often provided by developed countries, have positive effects on the after tax rate-of-return on new investment and stimulate both domestic fixed investment and attract additional investment from abroad, at least in the short run (Boskinand Gale, 1986).

But other viewpoints are similarly compelling. For example, Young (1988) agrees that tax rates may have some impact on FDI through retained earnings. Foreign direct investment through new funds is inelastic with respect to tax rates and rates of return. There is no consistency of evidence that location decisions would be significantly changed if dividends were to be exempt from US corporate tax (Altshulerand Grubert, 2001).

The study "Fiscal Incentives, European Integration and the Location of Foreign Direct Investment," by Hubert and Pain (2002) found a modest positive impact for corporation taxes and found other fiscal instruments such as investment in infrastructure to have significant positive impact on FDI decisions. As controversial as this topic is with respect to FDI

determinants, fiscal measures and subsidies remain the single most common policy governments can manipulate in the overall foreign investment regime (Mbekeami, 1999).

2.1.3.5 Budget Deficit/Surplus

The fiscal discipline of a government is often reflected in its national budgets. While a budget deficit in a particular year may not construe fairly accurately how government performs in that year, generally, consistent surpluses/deficits tend to show disciplined or lack of disciplined fiscal policy (Schoeman, 2000). In most countries of Africa, budget deficits have made their marks for most of the 1980s and 1990s. With the budget showing red ink most of these years, it would be difficult to make the economic improvements that are needed to attract foreign investors. For example, the budget deficits expressed as a percentage of GDP have remained high since the first half of the 1990s in countries like Kenya and Zimbabwe (Pigato, 2001).

2.2 Effects of Fiscal Incentives on FDI

The increasing mobility of multinational corporations in combination with the fact that barriers to global capital flows are gradually becoming eliminated have led to substantial stimulation of competition to attract FDI among governments, often through fiscal incentives. This is owed to the significant role played by FDI in the development process, which make governments to put extra efforts in their attempts to attract FDI(Calderónand Schmidt-Hebbel,2008 ; Christiansen,Oman and Charlton,2003 ; Clark,2000 ; Easson,2001 ; Halvorsen,1995). However, one of the most significant challenges that developing countries especially those located in Africa are facing is ensure that they progressively attract substantial FDI throughout the year. The limited or lack of success for previous attempts which have been made to create conducive environment for FDI has necessitated developing countries to divert their focus on other FDI attracting instruments that are more appealing. However, the notion that developing countries are high-risk investment regions must be dispelled first if substantial FDI is to be attracted because FDI inflows are highly sensitive to political and economic risks. Thus, many developing countries have combined the above attempts with fiscal incentives, in order to ensure they attract significant FDI(Halvorsen,1995 ; Hartman,1985 ; Morisset and Pirnia,2001) .

Therefore, as more and more countries continue to devise the necessary methods to attract the much needed FDI and enhancethe benefits that ensue such as technology spillovers, job creation and managerial skills, fiscal incentiveshave become animportant instrument of attracting FDI. Despite the fact that, this trend of using fiscal incentives is relatively new, it appearsto have experienced significant strengthening over the last two decades and nowadays it has become a global phenomenon. At first glance the influence of fiscal incentives on FDI appears ambiguous, but a keen evaluation reveals its potential to significantly improve FDI in a country. This is mainly because some of the previously conducted surveys and time-series econometricanalysis had indicated that fiscal incentives did not rank as the most influential factor considered by foreign investors in their decisions to select investment locations(Calderónand Schmidt-Hebbel,2008;Christiansen,Oman and Charlton, 2003; Clark,2000 ;Easson,2001 ; Halvorsen,1995 ;Hartman,1985 ; Morisset and Pirnia,2001).Thus, highlighting that there are other more important factors to determine attraction of FDI such factors as political stability, basic infrastructure as well as the costand availability of resources and labour. This implies that the above mentioned factors are more important in attracting FDI in a country compared to FDI because foreign investors consider fiscal incentives to be a poor instrument for compensation of other negativefactors that characterise investment climate in some developing countries.

However, despite these findings the impact of fiscal incentives on FDI cannot be underestimated(Calderónand Schmidt-Hebbel,2008;Christiansen,Oman and Charlton, 2003; Clark,2000 ;Hartman,1985 ; Morisset and Pirnia,2001) It is not a coincidence that there has been positive correlation in many developing countries between the levels of fiscal incentives and the extent of FDI attraction. In particular, countries that have offered substantial tax incentives to foreign investors over the past two decades have managed attract significant FDI. Moreover, in recent years the evidence indicating that fiscal incentives are an important determinant of FDI has continued to grow implying that fiscal incentives influence the decisions of foreign investors in selecting investment locations(Halvorsen,1995;Hartman,1985) . Furthermore, it has also been observed that fiscal incentives have a substantial impact on the composition of FDI than on its level. In fact, many governments are nowadays using fiscal policies in their attempts to attract FDI in particular sectors of the economy rather than increasing the overall level of FDI(Easson,2001 ; Halvorsen,1995 ; Hartman,1985 ; Morisset and Pirnia,2001).

2.2.1 Types of fiscal incentives

Fiscal incentives have been extensively provided by many developing countries to entice foreign investors to locate their production facilities in their economies which would translate to high levels of FDI. This has necessitated respective governments to use a number of fiscal incentives that lead to significant reduction of the effective tax rates that would be paid by the multinational corporations thereby increasing levels of FDI(Halvorsen,1995 ; Hartman,1985 ; Morisset and Pirnia,2001). Different types of fiscal policies have been used and much focus has been directed on fiscal policy instruments that have direct connection to corporation income tax including tax holidays and tax allowances, which help the foreign investors to increase their profitability. Local indirect tax and custom duties exemptions are also used in many countries(Calderón,Schmidt-Hebbel,2008 ;Christiansen, Oman and Charlton,2003). Moreover, developed countries often use grants to attract FDI, which are rarely used by developing countries because they are too expensive. However, the fiscal incentives commonly used to attract FDI in developing countries are discussed below.

2.2.1.1 Reduced corporate income tax rate

In order to attract FDI, governments often set low corporate income tax rates which exempt foreign investors from thegeneral tax regime. This instrument has been frequently used by governments to attract FDI into particular sectors of the economy or regions of the country(Easson,2001 ; Halvorsen,1995). This fiscal incentive may be targeted at foreign investors' incomes who meetparticular criteria previously specified or towards attracting more FDI.

2.2.1.2 Losses carrybackwards or forwards

In most cases, when a country use low corporate income tax rates as a fiscal incentive, chances of using additional mechanisms for further reduction of the effective tax rate are very high. One such mechanism which is commonly used is allowing foreign investors tocarry their losses backward or forward for a specified number of years (which in most cases is between three and five) for the purposes of tax accounting(CalderónAnd Schmidt-Hebbel,2008 ; Christiansen,Oman and Charlton,2003 ; Morisset And Pirnia,2001). However, only a ration of the loss which is fixed with an upper limit is usually allowed to be carried backward or forward. This measure is particularly very essential at attracting FDI from foreign investors whose projects are envisaged to run losses at their initial stages as they

continue with their plans towards increased production and market penetration. A combination of low corporate income tax rates and losses carry backwards or forwards for the purpose of taxation is considered an appropriate measure towards effective tax reduction and one that is highly effective to attract FDI(Tanzi and Zee, 2000; Wells, Allen, Morisset and Pirnia,2001).

2.2.1.3　Tax holidays

The other fiscal incentive often used by governments to attract FDI in developing and transition countries is tax holidays. Under this fiscal incentive, newly established firms that qualify are exempted from corporate income tax payment for a specified number of years. Firms qualifying for tax holiday provisions may also be exempted from tax liabilities(Christiansen, Oman and Charlton,2003 ; Clark,2000 ; Hartman,1985) . Taxholidays have been appropriately as a fiscal incentive by many governments towards elimination of tax on net revenues from FDI projects throughout the holiday period,which, on the basis of the considered case tends to substantially encourage FDI. When tax holidays are applied by the host country, firms are denied certain tax deductions over the period of tax holiday or indefinitely(e.g. interest expense and depreciation costs), which tends to at least partially offset anystimulative effect(Morisset and Pirnia,2001; Halvorsen,1995; Easson,2001;Calderónand Schmidt-Hebbel,2008) .

2.2.2　Fiscal incentives on FDI in Libya

In order to create conducive environment for FDI attraction in Libya, new and classical fiscal incentives as well as facilitations and guarantees for foreign investors have been established. In particular, several fiscal incentives have been established in Libya with an aim of improving levels of FDI as well as increasing rates of FDI attraction (Easson,2001 ; Halvorsen,1995;Hartman,1985;Morisset and Pirnia,2001) . For instance, exemption from income taxes on the activities of any projects carried out by foreign investors for aperiod of five years after the production orworkcommencement date. However, at the General People Congress discretion and decision,and upon the Secretary's request, additional three years may be added on the exemption period. Moreover, foreign investors are also exempted from customs and other import taxes of machineries and equipment for the FDI project realization as well as the necessary inputs to facilitate the project operations during its initial five years

of activity(Halvorsen,1995;Hartman,1985). Finally, foreign investors are also exempted from taxes as well as custom taxes to export as an important fiscal incentive which stimulates attraction of more FDI in Libya considering that many foreign investors have keen interest in the oil and natural gas and manufacturing sectors of the Libyan economy.

2.2.3 Risks of fiscal incentives

Although enhanced fiscal incentives is key to helping many developing countries attract FDI, there are risks associated to such incentives that necessitates consideration. For instance, opponents of fiscal incentives have argued that fiscal incentives may lead to significant loss of revenue which may outweigh the envisaged benefits(Halvorsen,1995 ; Hartman,1985; Morisset and Pirnia,2001). They also believe that problems like governance and corruption would be exacerbated through fiscal incentives and it would be better for developing countries to stabilise the macro-economy and improve the local infrastructure rather than taking the risks associated with fiscal incentives. Moreover, fiscal incentive programs to attract FDI have in some cases opened avenues for tax avoidance schemes which transfer the created burden to the national budget. Hence, in order to balance the fiscal budget, the revenues lost through these schemes have to be recovered through curtailed essential social expenditures or added domestic taxes(Calderón and Schmidt-Hebbel,2008 ;Christiansen, Oman and Charlton,2003; Clark,2000;Easson,2001;Halvorsen,1995 ; Hartman,1985 ; Morisset and Pirnia,2001) .

Fiscal incentives and particularly tax incentives can result in economic distortions that are long-run and costly. This is attributed to the fact that some activities are usually pursued over others not due to their competitive advantage but due to artificially enhanced profitability as a result of preferential tax treatment. Additionally, if low productivity investments are fostered through fiscal incentives, this may lead to diversion of resources from other projects that are more productive(Charlie,2007; Creswell,2003;Sornarajah,2004).

Furthermore, tax incentives motivated by fiscal incentives to attract much needed FDI in developing countries including Libya have in most cases imposed substantial compliance and administrative costs on both foreign investors and governments. They lead to inherent complication of the tax system due to differential application of taxation rules to different taxpayers(Calderón and Schmidt-Hebbel,2008 ;Christiansen, Oman and Charlton,2003; Clark,2000;Morisset and Pirnia,2001). This necessitates skilled staff, complex legislation and

sophisticated taxation systems for preventing tax avoidance thereby leading to diversion of limited resources from other administrative tasks that are important. In addition, these controls in the taxation system may result in uncertainty and delays, which lead to increased financial risks for companies undertaking FDI (Halvorsen,1995 ; Hartman,1985 ; Morisset and Pirnia,2001). Thus, while fiscal incentives have the potential of increasing FDI inflow, if measures for their effective management are not implemented, their detrimental effects could outweigh their benefits on the country's economy (Ahlquist,2006;Alfaro,Chanda, Kalemli-Ozcan and Sayek,2004 ;Charlie,2007;Creswell,2003;Gachino,2006;Konings,2001;Ragazzi,1973).

2.3 Foreign Direct Investments

Foreign direct investment (FDI) is a very significant phenomenon on international trade today and plays an important and continuously growing role in global business. FDI is the investment made by a particular country in another mostly through MNCs based in the former country. FDI has the potential of providing a company with new markets and channels of marketing, access to new technology, cheaper production facilities, as well ascheap labour and resources. For the host country receiving FDI, it can act as a source of capital, processes, new technologies, management skills, and organizational technologies, and as such have the potential of providing a strong impetus to the host country's economic development. In its classic definition, foreign direct investment is defined as the physical investment made by a company from one country into factory or industry building in another country(Ahlquist,2006;Alfaro,Chanda, Kalemli-Ozcan and Sayek,2004;Gachino,2006; Konings,2001;Ragazzi,1973).The FDI in buildings, equipment and machinery is different from portfolio investment, regarded to be an indirect investment. Given the rapid changes and growth in the patterns of global investment over the recent past, the definition of foreign direct investment has been broadened so that it encompass the acquisition of a long run interest in the management of an enterprise or a company outside the home country of the investing company. As a result, in modern international market definition of FDI may take many forms including construction of a production facility, a direct acquisition of a foreign firm, or strategic alliance with a company that is locally based with input of technology from the attendant, or investment in a joint venture as well as licensing of intellectual property.FDI has taken a very crucial position over the past decade as well as playing a major role in the business internationalization. The scope, size, and methods of FDI have experienced

profound changes as a result of reacting to advancements in production technology, increasing liberalization of regulatory frameworks that govern investment in enterprises, as well as the tremendously changing capital markets. Moreover, declining costs of global communication and the growing new information technology systems have made the work of managing FDIs far much easier than in the past. The enormous changes in investment and trade policies and the global business regulatory in the past decade, including tariff liberalization and trade policy, acquisition in many nations and easing of FDI restrictions, as well as the privatization and deregulation of many companies, have significantlyinfluenced expanded role of FDI in the past decade.

However, FDI has led to profound effects in developing countries, where annual FDI inflows have tremendously increased over the last four decades from annual averages of below $10 billion in the 1970's to annual averages of below $20 billion in the 1980's. However, in the 1990s the value of FDI experienced an explosive growth where in 1990 it accounted for about $26.7billion to approximately $179 billion and $208 billion in 1998 and 1999 respectively, and now FDI comprise a significantly large portion of global trade.   Driven by internationalization, mergers and acquisitions of production in a wide range of companies, FDI has become an indispensable part of international trade. FDI proponents point out that the investment flow exchanges benefits both the host country and the home country, but opponents of FDI reiterates that multinational conglomerates have the potential of wielding great pressure over weaker and smaller economies thereby driving out much local competition. FDI represents a chance to small and medium sized companies to big multinational corporations or conglomerates to have a more active role or participation in international business activities.

For small and medium sized companies, FDI represents an opportunity to become more actively involved in international business activities. Over the last two decades, there has been considerable change in the classic definition of FDI. However, this classic definition change notion must be maintained in the proper context. For example, it can be clearly stated that, over 2/3 of FDI is made in the form of equipment, machinery, fixtures, and buildings. In addition, an overwhelming percentage of FDI globally is controlled by larger multinational conglomerates and corporations. Furthermore, the advent of the Internet, loosening of restrictions to FDI in many markets, increased role of technology, as well as continued decrease in communication costs implies that newer forms of FDI will in the future play

asignificant in international business. Therefore, many governments, especially in developed and industrialised nations, give FDI a priority and also pay very close attention it since FDI inflows and outflows have a significant impact on their economies. Hence, an effective monitoring of FDI inflows and outflows data is very crucial in determining the impact of FDI on the overall economy as well as acting as a helpful factor in the evaluation of industry segments.

2.4 Fiscal policy concept, types and their relationship to monetary policy

2.4.1 Definition of fiscal policy

Fiscal policy is defined as the schedule for government spending and income collection through implementation of taxation in order to influence the economy. Thus, a government is actually engaged in fiscal policy when it is making decisions on the goods and services to purchase, the distribution of transfer payments, or the taxes to be collected. This implies that fiscal policy aims to influence a country's economy by determining the level of government spending as well as levels and how revenue will be collected. Any government around the world introduces fiscal policy on annual basis in order to cope with the challenges it faces in its economy and improvement of society. However, the economic impact of fiscal policy such as any change in the government spending has direct influence to particular groups of the society. For example, a tax cut for married couples with children will increase their disposable income. In general, the focus of fiscal policy discussions is usually on the effect of government budget (spending and income collection) changes on the overall economy. Fiscal policy tends to be contractionary or tight when government spending is less than revenue collection (i.e., when there is surplus in the government budget) and expansionary or loose when government revenue collection is lower than spending (i.e., when there is deficit in the government budget).

2.4.2 Instruments of fiscal policy and its implications

2.4.2.1 Instruments

In order to execute fiscal policy, governments use different fiscal policy instruments for controlling national as well as international economies. However, instruments of fiscal policy fall into two main categories such as fiscal policy instruments for expenditure and fiscal policy instruments for revenue collections. The former fiscal policy instruments are aimed at ensuring appropriate allocation of finances in government spending and are involved

in raising the standard of living for the country citizens by injecting government revenues into revitalization and development projects while the latter encompasses all forms taxes and tariffs charged by governments on commercial enterprises and consumers. However, there are two main instruments that are involved in fiscal policy discussed below:

2.4.2.1.1 Taxation

Taxation is undoubtedly one of the major instruments of fiscal policy involved in revenue generation for governments. Indeed, taxation is the ultimate determinant of a government's revenue collection. For instance, taxation has significant influence on the direction of overall economy since when the government decreases or increases personal and value added taxes, this leads to an increase or decrease in the amount of money available for consumers disposal. Therefore, a decrease in personal and value added taxesreduce government revenue, while at the same time increasing money for consumers. This may reduce government spending while increasing consumerspending leading to increased revenues for businesses enterprises, which then allows their expansion and hiring of more workers. Thus, cutting of personal income and value added taxes is a fiscal policy instrument commonly used by governments to encourage economic growth. Moreover, government taxation on commercial enterprises including custom duties, import taxes, export taxes, tariff rates have significant impact the level of revenues generated by governments.

2.4.2.1.2 Government Spending

The second main instrument of fiscal policy is government spending. However, government expenses exist in two main forms such as government consumption and government investment. The former expenses are involved in offsetting current expenses of the government such as wages and salaries of civil servants and other expenses involved in day-to-day operations of the government. However, the latter expenses are used to determine government investments aimed at generating revenue for the government. The government expenditures can lead to promotion of economic activity and creation of jobs. Thus, higher levels of government spending, especially in terms of government investments promote employment and growth of the economy.

2.4.2.2   Implications of instruments of fiscal policy

Instruments of fiscal policy are important in the economy administrating because of its abilityto influence gross domestic product. For instance, fiscal policy instruments raise the demand for a country's goods and services. Thus, fiscal policy instruments can be used to create superiordemand which results to an increase in both good's output and prices. However, a country's business cycle state plays a crucial role in determining the degree to which high demand caused by the instruments of fiscal policy increases output and prices. Therefore, the ability of fiscal policy instruments to influence output of certain goods by affecting aggregate demand makes them an important tool for stabilizing the economy. In a recession, an expansionary or loose fiscal policy can be run by the government, thus using instruments of fiscal policy in particular way to help in the restoration of economy output to its normal level as well as creating jobs. However, during a boom when the budget has a surplus and unemployment is not a problem but a greater economic risk is posed by inflation, a contractionary or tight fiscal policy helps to counter the inflation impact to economy.

Instruments of fiscal policy that lead to fiscal growth affect the level of goods output in the long-run due to their influence of saving rate in a country. The total saving in a country consists of two parts: government saving (represented by the budgetsurplus) and private saving (by corporations and individuals). A decline in the rate of government saving is usually entailed in a fiscal expansion where lower saving in a country implies that less budget will be devoted to construction of new industries and equipment or the country's debt will increase as a result of overseas, both of which in the long-run will lead to repulsive consequences to the economy. Moreover, decreased government spending on investments will definitely lead to low capital stock thereby reducing the ability of acountryto meet the required production output in the future.

Furthermore, instruments of fiscal policy usually change a country's burden which may be caused by future taxes. For instance, a government increases its liability stock when it runs anexpansionary fiscal policy. However, since the government will be required to pay interest in future years for the increased stock of liability, adoption of expansionary fiscal policy instruments will impose additional burden on taxpayers in the future. Thus, instruments of fiscal policy such as taxes can be used to facilitate income transfer between different classes in a country while the same instruments can be used to create surpluses or deficits in

government budgets so that income can be transferred between different generations.In addition to the above implications of instruments of fiscal policy discussed, the instruments of fiscal policy have direct impact on the economy as a result of altered incentives. For example, activity taxation encourages its decline. This implies that an increase in marginal tax rate on income leads to substantial reduction of the motivationof people to earn income in addition to reducing their purchase power. However, a decrease or constant level of taxation, through government's reduction of marginal tax rates and deductions on income will end up transferring more money to consumers implying that they will have more disposable income leading enhanced output and economic growth. This will motivate more people to participate in the labour market and generate income. This means that the instruments of fiscal policy have the potential of influencing dynamics of labour market in a country as indicated above.

2.5 The reality of fiscal policy in developing countries

The fiscal policy in developing countries has been a subject of extensive empirical research over the past few decades where more focus has been directed to the identification of the actual fiscal policy adopted by such countries. Thus, procyclical fiscal policy has been the fiscal policy widely adopted in developing countries, in contrast to countercyclical fiscal policy adopted by developed high-income countries. This had made the idea that procyclical fiscal policy is the one usually used in developing countries to reach the status of conventional wisdom(Ahlquist,2006;Alfaro,Chanda, Kalemli-Ozcan and Sayek,2004;Charlie,2007;Creswell,2003;Gachino,2006;Konings,2001; Ragazzi,1973). Therefore, the procyclical fiscal policy in developing countries had become a well-established empirical phenomenon that could not be explained using Keynesian or neoclassical theory. However, various possible causes of this phenomenon characterised by sub-optimal policies have been identified including institutional weaknesses,boom-bust cycles in the international markets and social tensions.

In the past, the fiscal policy in developing countries tended to be solely procyclical where during the periods of expansion they cut taxes (or increased spending) while during periods of recession they raised taxes (or cut spending). The procyclicality of fiscal policy in developing countries has been widely documented by many authors in comparison to the countercyclical fiscal policy that has been by large extent observed among developed or

industrialized countries(Aitken and Harrison,1999;Akinlo,2004;Alesina,Campante and Tabellini,2008;Alesina and Perotti,1996;Alfaro and Charlton,2009;Blomström,1986;Buckley and Casson,1976 ; Christiansen,Oman and Charlton,2003;Creswell,2003;Dunning,1998;Grossman and Helpman,2002;Mendoza and Oviedo, 2006;Sethi, Guisinger,Phelan and Berg,2003;Yin,1994). Most of the studies that focus on the procyclical fiscal policy among developing countries have put more emphasis on government spending due to the endogenous tax receipts with respect to the cycle of business. In fact, the procyclical pattern of government spending has been precisely attributed to the fact that there is tremendous increase in government receipts from natural resources royalties or taxes in booms making the governments of developing countries unable to resist the political pressure or temptation to proportionately increase spending, or more. This implies that there is a positive correlation between government spending and GDP in developing countries and indication of procyclical government spending and collection of revenues, which is, destabilizing. Alternatively, in developed countries the correlation is negative indicating a countercyclical government spending, that is, stabilizing.

However, it has not been sufficiently convincing why policymakers in developing countries had persistently continued to advise their governments to pursue procyclical fiscal policy. This is mainly because there is a large extent of undesirability caused by procyclicality patterns of government's fiscal policies whoseoutcomes exacerbate the business cycle amplitude. Political distortions and imperfect access to credit have been the most convincing explanations that describe this phenomenon. On the other hand, in an historic reversal, it can be observed that there has been a considerable achievement of countercyclical fiscal policy in many developing countries over the last decade. This is mainly because over the last decade an historic shift in the behaviour of fiscal policy that is cyclical in the developing world. However, not all developing countries have managed to shift from procyclical to countercyclical fiscal policy since there are still a considerable number of developing countries that are still using procyclical fiscal policy.

The evidence of countercyclical fiscal policy among many developing countries can be seen to match up with other criteria used to judge maturity in conducting fiscal policy, including rankings by rating agencies, debt/GDP ratios as well as sovereign spreads. Low income market or developing countries have over the last 5 years achieved average annual debt/GDP levels that are approximately 40% of GDP, an indication of improved fiscal policy

management compared to advanced countries whose debt/GDP levels have continued to rise. This historic turnaround in fiscal policy by the developing countries seems to have been ratified by the financial markets. Thus, some developing countries seem to be ranked favourably by rating agencies than their advanced or developed counterparts in terms of spreads and creditworthiness. Hence largely due to the improved fiscal situations over the last decade, a considerable number of emerging and developing countries managed to more quickly bounce back after the global financial crisis of 2008-2009 in comparison to developed countries. However, the main reason why many developing countries have managed to shift from procyclical fiscal policy to countercyclical fiscal policy is the improvement in their institutions.This is mainly because some research into this phenomenon has confirmed that there is an inverse correlation between a fiscal policy in a country with the quality of the country's institutionsincluding measures of bureaucracy quality, law and order, corruption, social and political stability as well as other risks to investment.

2.6 Globalization and fiscal policy in developing countries

Globalization has been very instrumental in making economies more open which leads to significant implications for fiscal policy. However, as developing countries continue to join globalizing world they need to implement some reforms that increase their level of public spending. Thus, when the domestic markets of developing countries are rapidly opened as a result of globalization, the government are subjected to the pressure of assisting their citizens who loose capital or jobs due to the impact caused by the competition from foreign investors. This implies that public spending will increase in developing countries due to globalization. Moreover, it can also be argued that a more opened domestic market in a developing country due to globalization poses greater risks for its citizens. And since one of the fundamental roles of a government is to protect its citizens from risks, then the opening of economies due to globalization will result to increased levels of public spending in the government's attempts to set up safety nets for the country citizens. This leads to gradual increase in growth in the public spending into GDP ratio.

However, prior to globalization most developing countries tended to have closed economies that usually have primitive forms of social protection which is more based on regulations by the government rather than public spending. This is mainly because in developing countries provision of social protection is done through: (a) tenure of jobs; (b) controlling some basic commodities' prices; (c) low utility prices; (d) high levels of public enterprise's employment;

(e) rent controls and public housing; (f) minimum wages; (g) subsidized forms of credit and so on. This form of social protection is often inequitable, random and inefficient. However, this traditional safety net in developing countries is dismantled by globalization thereby putting more pressure on the government to replace it with a more modern and more formal system of social protection. Such a system could include provision of minimum pensions, family allowances, unemployment compensation as well as free meals for school children among others. These programs eventually lead more increased public spending levels. Therefore, these effects of globalization has for most developing countries increased public spending levels which have been in the past much lower compared to those of developed or industrialized countries. This shows the connection between globalization and changes in public spending levels experienced by developing countries as their domestic markets continue to become more open. This has a significant influence on the fiscal policy in developing countries.

In the past, public spending and tax levels were much lower, but the increasing levels of public spending caused by globalization will necessitate an increase in tax levels. However, this measure will definitely cause some distortions in the country's economic activities as well as discouraging efforts, implying that care must be taken when a decision to raise taxes is considered. This is mainly because the same globalization opens the country's frontiers to freer trade thereby experiencing some losses in revenues as a result of lowering or elimination of import duties. Moreover, these modern tax systems have increased burden for the personal income tax and value added tax as developing devise measures to cover for increasing public spending. However, globalization has also increased levels of foreign direct investment (FDI) in developing countries from companies based in developed countries which has increased levels of corporate income tax rate. Both of the two factors above have significant influence on fiscal policy in developing countries.

Therefore, it should be noted that globalization will have significant impact on fiscal policy in many developing countries as its associated pressures continue to bring down level of taxation, and this is attributable to various reasons. First, globalization leads to opened economies that require elimination of foreign trade taxes which have been a very important source of revenue for developing countries and there elimination will definitely cause some difficulties for such governments, thus necessitating their replacement with other taxes. Second, the marginal tax rates for corporate income taxes and for personal income taxes have

significantly reduced as a result of international tax competition, in fact, the rates have fallen by about 20% on average over the past two decades translating to a reduction overall revenue for developing countries. This has led to significant impact on fiscal policy in developing countries. Third, the ease of financial capital mobility is forcing developing countries to reduce taxes on this crucial tax base which has led to dual income taxation introduction where financial capital is taxed at lower rates. Finally, globalization has made putting high taxes on luxury products very difficult because individuals can take advantage of opened markets to outsource for these products from markets where tax rates are low.

CHAPTER III: THE IMPACT OF FISCAL POLICY ON THE INVESTMENT'S CLIMATE

3.1 The investment climate and attract foreign direct investment.

3.1.1 The theoretical framework for the investment climate

For any country to attract substantial foreign direct investment (FDI), the investment climate must be conducive where foreign investors are guaranteed of minimal infrastructural and policy challenges which would in turn improve returns on their investments as well as profitability. However, investment climate in a country is considered to be the economic and financial conditions influencing whether foreign investors are willing to invest their money in order to acquire a stake in the country's economy(Morisset and Pirnia,2001;Hartman,1985;Halvorsen,1995). Many factors usually affect the investment climate such as national security, poverty, crime, political instability, infrastructure, workforce, regime uncertainty, property rights, government regulations, taxes, rule of law, government accountability as well as government transparency. When the investment climate is unfavourable, it usually hinders FDI inflow into a country and this has been one of the greatest faced by developing countries. However, in order to address these challenges regulatory reforms are commonly the key components facilitating the removal of the barriers towards creation and improvement of an effective investment climate. This has also been facilitated by the establishment of not for profit organizations for the purpose of creating and improving the investment climate as well as making sureeconomic development is spurred through increased FDI in the concerned countries(Clark,2000;Easson,2001;Morisset and Pirnia,2001).

However, considering the role played by the status of investment climate towards determining the rate of FDI inflow in a particular country, there has been several theories and concepts developed to explain this phenomenon. The investment climate is a complex set of overlapping and interconnected systems used in the definition of rules and regulations as well as policies administered by the government that affect both local-owned and foreign-owned businesses(Buckley and Casson,1976;Christiansen,Oman and Charlton,2003;Clark,2000;Morisset and Pirnia,2001). In this regard, this case study will adopt a theoretical framework encompassing the contribution of policies, regulations, rules, and requirements both formal and informal deemed essential to fulfil for a business to begin

its operations. In particular, the Business Enabling Environment (BEE) theoretical framework outlining the core exchange between government and businesses will be considered. However, despite the crucial role played by the government in ensuring that favourable investment climate is created and improved for tremendous attraction of FDI, the private sector has also in the recent past positioned itself strategically in order to compliment government efforts in the creation and improvement of favourable investment climate. Thus, the interconnected systems involved in determining investment climate in a country are both within and outside government where stakeholders outside the government include businesses organisations, civil society, and media. A poor BEE in a country which negatively affects FDI inflow results from underlying systemic failures particularly in the area of the formulated and implemented rules, regulations and requirements(Ahlquist,2006;Alfaro,Chanda, Kalemli-Ozcan and Sayek,2004;Charlie,2007;Creswell,2003;Gachino,2006;Konings,2001;Ragazzi,1973).

A keen evaluation of the Business Enabling Environment (BEE) theoretical framework explanation of investment climate shows that it is always necessary for such a framework to be adopted for close monitoring of the investment climate in a country. This is essential if a country is interested in attracting substantial foreign direct investment. For simplicity of exposition, the narrow definition of the BEE theoretical framework and its potential towards influencing investment climate can be regarded as the policies, rules and regulations as well as formal and informal requirements, primarily administered by the government that must be dealt by both locally-owned and foreign-owned businesses in order to conduct business operations in a country. When the theoretical framework is beneficial leading to favourable investment climate, it leads to creation of a level playing field for foreign investors and protection of consumer welfare, by addressing market failures as well as facilitation of a dynamic and increasingly growing and mature markets. This leads to tremendous attraction of foreign direct investments in all sectors of the economy eventually resulting to improved economic development. However, whenthe theoretical framework is detrimental meaning the investment climate is unfavourable; it results to creation of barriers, unnecessary costs, uncertainty and numerous challenges that impede local investments and foreign direct investments(Ahlquist,2006;Alfaro,Chanda, Kalemli-Ozcan and Sayek,2004;Charlie,2007;Creswell,2003;Gachino,2006;Konings,2001;Ragazzi,1973).

Moreover, the key principle that underpins a systems approach indicates that when the theoretical framework is indicative of a poor BEE the favourability of the investment climate is undermined as a result of underlying systemic failures due the formulated and implemented rules, regulations, policies and requirements. Therefore, unless programmes and legal framework aimed at addressing these underlying constraints are devised in order to create and improve the investment climate in the country, then attraction of foreign direct investment becomes a challenge. Furthermore, systems approach is another effective way of promoting and sustaining BEE reform as well as maximizing the improvement of the investment climate in a country by prioritising economic practises that promote attraction of FDI. These approaches have to be inclusive by integrating the private sector in the process of decision making as well as policy formulation and implementation with the purpose of creating a more liberalised and open market where foreign investors can operate with minimal hindrances leading to improved returns on capital and increased profitability. Also this theoretical framework encourages a multi-disciplinary approach to be taken by the government in the design and implementation as well as integrating sustainability challenges and political economy into the core of programmes aimed at creating and improving favourable investment climate(Ahlquist,2006;Alfaro,Chanda, Kalemli-Ozcan and Sayek,2004;Charlie,2007;Creswell,2003;Gachino,2006;Konings,2001;Ragazzi,1973).

In addition, this theoretical framework cannot work in isolation and mapping out theories of change that have the potential of proactively managing the complexity caused by the interconnectedness of investment climate systems is necessary. This also necessitates the prioritisation of stronger measurement and results that can be used in the management and adaptation of the programmes devised towards creating and improving investment climate. Moreover, for substantial attraction of FDI value of money must be maximised through increased sustainability and impact at scale as well as ensuring that there is tremendous reduction of operational costs through utilisation of resources and local systems at sensible pace. This theoretical framework which also considers the rate of market development has a framework which can be used to assess market systems as a way ofconducting diagnostics in the identification of underlying systemic failures in the attempts to develop and implement interventions that effectively address such failures as well as evaluation of the outcomes of the implemented interventions. This works effectively to ensure that the favourability of the

investment climate is constantly monitored with the aim of making sure more FDI is attracted into the country. Finally, for the BEE theoretical framework to enable creation and improvement of the investment climate, a framework market systems development to be adopted should encompass a private/public interface system where a core exchange between government and business, especially from foreign investors should be encouraged. For example, the government providespolicies, procedures, rules and regulations necessary to facilitate foreign investments to flourish, and in exchange the foreign investments supply jobs, provide revenue through taxation as well as promotion of economic growth required by the government to meet governance and political objectives.

3.1.2 Creating and improving the investment climate

A good investment climate is core towards fostering productive local private and foreign private investments the engine for economic growth in every country around the world where private investments accounts for a significant share of GDP. When an investment climate is favourable, it leads to expansion of the variety of available goods and services as well as reducing their cost and improved returns on capital(Kokko,2003;Konings,2001;Rweyemamu,1987). This encourages more local and foreign investors to increase their investments who the support a sustainable source of tax revenues to finance other importantsocial and political goals by the government. Hence, the need to create and improve investment climate is inevitable if a country is to attract significant foreign direct investments as well as encouraging substantial local investments. However, creation and improvement of a good investment climate is characterised by many features includingfinancemarkets, courts, and efficient infrastructure which complement each other to directly improve entrepreneurial activities in a country by foreign investors.

Creation and improvement of the investment climate is mainly done through the opportunities and incentives provided for foreign investors to invest productively andexpand through sustainable profitability. The investment climate varies enormouslyaround the world, and influences the decisions of foreign investors to locate their firms in particular countries. Therefore, it is necessary to ensure a good investment climate is created and improved in order to attract substantial foreign direct investments(Kokko,2003;Konings,2001;Rweyemamu,1987). This is mainly achievable through improved government policies and behaviours aimed at shaping the investment climate by making it more favourable for foreign investors. Thus, a top priority for

governments at all levels should be to create and improve investment climate for both local and foreign investors. To do so, the need for governments to understand how their behaviours and policies shape the incentives and opportunities for investors of all types,domestic and foreign, small and large, formal and informal,urban and ruralis inevitable.

In order to understand the investmentclimate, it is necessary to consider that profitability is the driving force for firms to invest. However, the investmentdecisions by firms are greatly affected by their ownstrategies, capabilities, and ideas as well as by theirassessment of the incentives and opportunities available in particular locations that are usually determined by the investment climate(Kokko,2003;Konings,2001). However, the incentives and opportunities that allow firms to invest productively are determined by the prevailing investment climate in a country, and their effectiveness to attract more domestic and foreign investments is evaluated by considering their impacton envisaged profitability. Moreover, profitability isinfluenced by other factors such as costs, risks, as well as barriers tocompetition all of which are closely linked to particularopportunities(Kokko,2003;Akinlo,2004;OECD,2007;Osman,2000;Phillips and Obwana,2000;Rweyemamu,1987). However, despite the fact that all the three factors are interrelated, each of them matters independently. For example, mitigation of some risks can be done by incurring greater costs while risks or high costs can be barriers tocompetition. In addition, it is also true that some barriers to competition may be essential in the reduction of risks for some firms whilst at the same time denying opportunities as well as increasing costs for others. This implies that a particular location's costs, risks, andbarriers to competition are usually shaped by many factors(Kokko,2003;Konings,2001).

Therefore, creation and improvement of investment climate is mostly done through enhancement of finance markets, courts, and ensuring there is efficient infrastructure. These interventions facilitate reduction of operational costs due to the available efficient, timely and convenient ways of carrying financial transactions and resolution of disputes. Efficient infrastructure also promotes a good investment climate through reduction of transport costs and ease of mobility. Moreover, formulation and implementation of appropriate economic policies that reduce barriers to investments is another way of creating and improving investment climate(Kokko,2003;Pongsiri,2004;UNCTAD,2003;Yin,1994). Furthermore, incentives, and particularly fiscal incentives are another appropriate way of creating and improving investment climate mostly through reduced taxation which in turn increases the

investors' profitability. In particular, these two factors: opportunities and incentives are the commonly available ways through which governments have been able to create and improve investment climate eventually attracting tremendous investments from both domestic and foreign investors(Kokko,2003;Konings,2001;Rweyemamu,1987).

Furthermore, the costs, risks and barriers to competition are the major factors that influence the creation and improvement of an investment climate. For instance, the costs of products production and distribution have impact on a variety of investment opportunities that may increase investor profitability. Reduction of high costs through unnecessary taxation is necessary for a good investment climate(Rweyemamu,1987;Kokko,2003). Moreover, these costs can also be significantly reduced by the government through supporting the infrastructure provision, providing public goods and mitigation of other market failures that may arise. Additionally, in order to create and improve investment climate the government needs to reduce investment risks. This is achievable through reduction of national crime levels, improving political stability in the country, eliminating unnecessary market regulations, devising appropriate interventions to cope with bribery and corruption as well as developing measures that help investors to cope with property rights associated risks. Moreover, the government can also devise policies and other necessary measures to regulate barriers to competition in order to ensure the prevailing investment climate is favourable(Kokko,2003;Konings,2001;Morisset and Pirnia,2001;Osman,2000;Rweyemamu,1987). Despite many firms preferring less competitive market, even more competitive ones pose greater potentials to the investor if appropriate measures are formulated and implemented by the government since competitive pressure mostly leads to improved productivity due to increased innovativeness by the investor. This is achieved through appropriate regulation of market entry and exit by investors as well as devising effective ways of responding to anticompetitive behaviours adopted by some investors(Kokko,2003; Rweyemamu,1987). This gives all investors a level playing field by ensuring that there is fair competition in the market.

3.2 Tax policy and foreign direct investment.

3.2.1   The relationship between foreign direct investment and tax

Considerable tax policy research for sometimes now has been directed to the investigation of the relationship between foreign direct investment and taxation, and the findings have these econometric studies has over time significantly changed. Historically, the impact of taxation considerations on FDI has been found to be insignificant. Moreover, observations from recent econometric studies indicate that under considerable circumstances taxation has significant influence on foreign direct investments(Kokko,2003; Rweyemamu,1987). Thus, in modern international business environment, taxation is believed to significantly influence investment location decisions made by foreign investors. Moreover, the continuously increasing association between foreign direct investment and taxation is attributable to tremendously increasing globalisation of the world economy, increased access to more detailed global trade and economic data, the undergoing harmonisation and coordination of international taxation systems as well as recent advancements in information and communication technology(Kokko,2003; Rweyemamu,1987).

When other determinants of foreign direct investment are held constant, there is an inverse proportional relationship between foreign direct investment and taxation. This implies that an increase in taxation reduces the level of foreign direct investment while a decrease in taxation leads to increased levels of foreign direct investments. According to the findings of econometric studies over the last 20 or so years, a consensus view has been arrived at indicating that a reduction in effective tax rate leads to increased levels of FDI. However, it has also been observed that this relationship between foreign direct investment and taxation is not universal since fiscal incentives just like other FDI determinants differ in their impact towards decisions on foreign direct investments across industries and sometimes among firms that are within a particular industry. For example, fiscal incentives are less significant determinant of foreign direct investments particularly where firms are seeking for resources or have the intention of serving the local market. In this case, there is relative binding of FDI to location where resources availability and market size are the overriding determinants(Kokko,2003; Rweyemamu,1987;Konings,2001). However, FDI which is efficiency-seeking, particularly in a manufacturing sector which is export oriented, tax relief leads to substantial response. This is mainly because these types of foreign direct investments are to a considerable extent more footloose in nature considering that the markets in which

they are made are highly competitive with slim margins. Therefore, operating costs minimisation, of which taxation incentives is an important way, is key to influencing decisions for FDI location involving an export-oriented manufacturing firm(Rweyemamu,1987).

Furthermore, it has also been observed that FDI, especially the efficiency-seeking FDI is not only sensitive to taxation, but also there has been progressively increasing sensitivity over time. This sharply increasing sensitivity of FDI on fiscal incentives has been attributed to globalisation and regionalisation of the world economy. This is attributable to the fact that trade liberalisation both globally and regionally, has enabled firms to be able to establish global production networks leading to shipment of larger output proportions to the international market rather than been consumed locally(Rweyemamu,1987;Tanzi and Zee,2000). This has led to tremendous reduction of the significance of market size, which has allowed competition for FDI between smaller and big countries where some decades ago the FDI would have obviously gone to the latter. In addition to markets integration, globalisation has also led to increased homogeneity in labour costs, skills base, infrastructure, macroeconomic performance as well as economic regulations. This has increased significance of disparities in taxation between countries as a determinant of FDI. Moreover, technological advancements in transportation and communication over the last three decades have also considerably contributed to this increased relationship between foreign direct investment and taxation. These advances have increased the mobility of firms that operate in knowledge-based industries including internet related businesses, insurance companies and banks. Low tax jurisdictions have played crucial role in attracting this type of FDI. Hence it can be stated that taxation has significant impact on FDI location, especially among developing countries characterised by similar competing investment fundamentals(Rweyemamu,1987;Kokko,2003).

3.2.2 Fiscal stimulus policies

Fiscal stimulus policies are often used during a recession or financial meltdown because the resulting reduction in consumer demand leads to idle resources that are unusually high such as closed factories and unemployed workers(Ahlquist,2006;Alfaro,Chanda,Kalemli and Sayek ,2004). This situation occurs because the private sector is not interested in spending due to reduced consumer demand, and the government through fiscal stimulus policies can take this opportunity an d occupy the place of the private sector through

increased spending, which puts idle resources back to utilisation (Christiansen,Oman and Charlton,2003;Charlotte ,2004).The resumption of the utilisation of idle resources, particularly workers results to a new source of income for them to spend thereby increasing consumer demand. Once consumer demand is increased enough and the spending also rises, the government spending is then slowed down since they are no longer necessary and the private sector resumes it previous role in the economy(Clark,2000 ; Frankel,2011). Therefore, fiscal stimulus policies are usually developed during an economic downturn or recession in order to ensure the country recovers as soon as possible. The effectiveness of fiscal stimulus policies is attributed to the simulative effect of increased government spending through expansionary fiscal policy. However, since fiscal stimulus policies leads to increased government spending, this means the national budget has a deficit which must be covered through public or overseas borrowing(Kokko,2003 ; Pongsiri,2004).

3.2.3   Tax competition and international tax coordination

Nowadays, the world is characterised by high mobility of labour, goods, factor inputs, capital, and other taxable activities, as well as ample opportunities for tax policy and profit shifting implying that fiscal externalities are likely to be strong in the redistribution of factor income and wealth internationally(Capron,1999;UNCTAD ,2005). In turn, this leads to significant but strategic implications regarding tax policy choices taken by governments as well implications for world welfare. This has led to increased attention both within academia and within politics concerning international tax competition and coordination. In addition, the recent dramatic rising in international capital flows has necessitated the need for international coordination of capital incometaxes. However, much of the available literature on tax competition has an inclination towards supporting the view that tax competition has the potential of driving source-based capital income taxes that are usually below their worldwide optimal level, and a global rise in capital income taxes that is internationally coordinated will lead to improvement of the welfare(Anyanwu,1998;Blomström and Kokko,1998;Capron,1999;Frankel,2011). However, standard analyses of taxcompetition have led to essential insights, but they typically rely on several strong assumptions such as the alternative to tax competition is international tax coordination among each and every country around the globe. However, in order for models of international tax competition and coordination to serve as a credible and reliable guide towards public policy, it must relax the current restrictive assumptions.

International tax completion has been greatly brought about by globalisation which knits separate national economiesinto one global economy. International tax completion is particularly occurring as a result of rising flows of investment and trade, rapid transfers of technology, and greaterlabour mobility.Reductions in investment and tradebarriers, deregulation of financial markets, and reduced transportation and communications costs have spurred the above trends(Rweyemamu,1987). This has led to liberalisation of markets making high tax rates unable to sustain due to increasing economic integration which has given businesses and individuals' greater freedom towards taking advantage of opportunities in foreign economies. Therefore, in modern economic environment as labour and capital mobility increases international tax competition also increases(Kokko,2003;Konings,2001). However, the current trend undertaken by most major countries has been to pursue tax reforms that ensure that their economies continue to attract investment. International tax competition has pressured countries to reduce tax rates in order to avoid directloss of skilled labour and capitalto countries that maintain lowtaxregimes. However, thetax competition equilibrium has shortcomings and is envisaged to be inefficient. This has made countries to begin coordination of their tax policies in the attempts of overcoming the inefficiencies of tax competition(Kokko,2003). International tax coordination occurs as a result of harmonisation of tax rates and policies among all countries across the world.

3.3 Public expenditure policy and foreign direct investment

3.3.1 Functional expenses and the investment climate

Functional expenses are relatively varied among and between countries, and are an on-going cost involved in the running of a business. For example, the purchase of capital machinery and equipment involves functional expenses used for maintenance and other inputs. Thus, in business, functional expenses are the costs incurred in day-to-day operations of the business including administration, research and development(Kokko,2003;Konings,2001). This implies that functional expenses are the sum of operating expenses incurred by a business for a specified period of time. Functional expenses usually vary from one country to another and an economic sector to another or between various regions in a country. When the functional expenses involved in running an investment or business are low, the investment climate is considered favourable. However, when the functional expenses involved in running a business are high, the investment climate is considered unfavourable (Easson,2001). Therefore, in order for a country to attract

substantial FDI, it must ensure that functional expenses involved in running a business are maintained low so that the investment climate remains favourable for both domestic and foreign investors (Calderónand Schmidt-Hebbel,2008; Djankov and Hoekman,2000;Faeth,2009;Hines,1996).

Some of functional expenses account for a relative share of overall expenses involved in operating a business in a particular country (Ahlquist, 2006). For instance, some of the functional expenses include: accounting expenses, maintenance and repairs, license fees, advertising, attorney fees and legal fees, office expenses, supplies, utilities (including telephone expenses), insurance, leasing commissions as well as salary and wages. These functional expenses must always remain relatively low in order to ensure that the investment climate remains favourable. However, when these expenses are high, the investment climate becomes unfavourable and prohibitive to both domestic and foreign investors(Christiansen,Oman and Charlton,2003 ; Clark,2000; Frankel,2011). This is attributable to the fact that high functional expenses reduce business profitability. Investment climate is favourable when business profitability is maintained high whilst investment climate is unfavourable when business profitability is low due to high functional expenses. The former attracts significant FDI while latter rarely attract FDI unless other determinants of FDI play a crucial role. Thus, functional expenses are essential in determining the nature of an investment climate(Kokko,2003 ; Pongsiri,2004).

3.3.2 Manufacturing expenses and the investment climate

Manufacturing expenses are another important determinant of an investment climate since they usually determine the market price of the manufactured products. Manufacturing expenses involves the costs of inputs such as raw materials and packaging materials. When manufacturing expenses are high the product prices definitely go high whilst when they are low the product prices also remain low(Kokko,2003;Konings,2001;Rweyemamu,1987). This implies that when manufacturing expenses are high, the manufactured products will be expensive and not competitive in the market while when manufacturing expenses are low the manufactured products are affordable making them market competitive. The former reduces business profitability while the latter significantly increase business profitability. This implies that when manufacturing expenses are high the investment climate becomes unfavourable whereas when manufacturing expenses are maintained low the investment climate becomes favourable. A favourable investment climate will attract significant FDI whilst unfavourable

investment   climate   rarely   attract
FDI(Kokko,2003;Konings,2001;Rweyemamu,1987;Osman,2000;Osman,2000).

3.3.3   Capital expenditures and investment climate

Capital expenditures (CAPEX) are the expense involved in the creation of future benefits for an investor or business. Capital expenditures are incurred when money is spend in a business either by purchasing fixed assets or through a process of adding more value to an existing fixed asset in order to extend its life or improving its efficiency(Kokko,2003;Konings,2001). Both domestic and foreign investors incur capital expenditures in the acquisition or upgrading of physical assets such as property, equipment, machinery, or industrial buildings.Capital expenditures are essential determinants of investment climate in a country. For example, when capital expenditures are high the investment climate becomes unfavourable whereas when they are low the investment climate becomes favourable(Kokko,2003;Konings,2001). The former scenario is attributable to high costs of investment capital which makes it extremely expensive to set up a production facility resulting to reduced FDI, however the latter scenario makes it easy to enter into the market due to the low costs involved in setting up of a production facility thereby attracting significant FDI.

3.4 The effects of a funding source and size of public expenditures on the investment climate

Public expenditures have over a long period of time been perceived to have significant effects investment climate. This is due to the fact that there has been a positive relation between the size of public expenditures and nature of investment climate. However, apart from the size of public spending influencing investment climate, the sources of funding are also deemed to have effects on investment climate (Kokko,2003). However, public expenditures are broadly categorised into two: consumption expenditures and capital expenditures. Both of them are facilitative towards achieving an efficient and favourable investment climate. For instance, when public expenditures are high, the investment climate will tend to be favourable while low public expenditures are often associated with unfavourable investment climate(Rweyemamu,1987). Consumption public expenditures facilitate the improvement of the nonphysical aspect of an investment climate through wages and salaries as well as consumables and other recurrent expenses that are directly linked to investment climate improvement.

However, capital public expenditures are the ones that have significant effects on the investment climate. This is mainly because capital expenditures are involved in the expansion of the public infrastructure investment. Investing in sustainable infrastructure plays a crucial role in the improvement of investment climate. This is as a result of improved transport and communication networks both of which make the investment climate to be favourable. These capital expenditures are used to invest in supportive or facilitative sectors that compliment the operations of domestic and foreign investments(Kokko,2003;Konings,2001;Rweyemamu,1987;Osman,2000;Osman,2000).

Furthermore, the source of funding for the public spending has effects on investment climate. For example, when the government entirely rely on taxation as a source of funding, the tax rates sharply increases making the investment climate unfavourable. However, when alternative sources of funding public expenditures such as public borrowing, grants/donations or external loans are outsourced the investment climate may remain favourable(Kokko,2003;Konings,2001;Rweyemamu,1987;Osman,2000).

CHAPTER IV: THE ROLE OF FOREIGN DIRECT INVESTMENT IN FUNDING THE ECONOMIC DEVELOPMENT IN THE DEVELOPING COUNTRIES.

4.1 The economic development and sources of funding

4.1.1 The concept of economic development

Economic development is referred to as the sustained, concerted actions of communities and policymakers that lead to promotion of economic growth and the standard of living in a particular area. It can also be referred to as the qualitative and qualitative changes in the economy where such actions also likely to involve multiple areas such as development of critical infrastructure, human capital, regional competitiveness, social inclusion, health, safety, environmental sustainability, literacy, as well as other initiatives. Economic development is usually different from economic growth. This is mainly because while economic development is an endeavour involving policy interventionswith aims of economic as well as social well-being of people, economic growth is a market productivity phenomenon and rise in GDP.

4.1.1.1 Economic Development and Growth

Economic development increases an economic capacity of a region towards creation of wealth for local residents(Bulan,2001 ; De Mello,1997). It is also dependent on deployment of the building blocks in the region including labour, facilities and equipment, land, financial capital, know-how, as well as other physical resources, and private and public infrastructure(Easson, 2001). Economic development is crucial for a region's on-going growth and vitality, but development itself is different from economic growth(Hartman,1985). For instance, economic development implies a qualitative change in what or how goods and services are produced through shifts in resource use, production methods, workforce skills, technology, information, or financial arrangements. An economy of a region can grow without changing if it simply produces more of the same goods and services and in the same manner.

In the broadest context, economic development efforts by the public-sector cover any capacity-building actions or investments, including, for example, roads and good schools. It is also argued that the best public-sector approach towards economic development is usually the one that focuses on efficiencies and investments that shape the broad economic

environment for labour and business through education, public safety, regulation, water and waste systems,the transportation infrastructure, and the overall tax structure(Bulan,2001 ; De Mello,1997 ; Easson,2001). In a narrower sense, economic development often refers to direct assistance for businesses and industries. In this case, the public sector takes action towards reducing risks or costs for businesses and thus encouraging business investment and productivity. However, both views, that is, the broad and the narrow are linked to the dynamics of regional economies and potential sources of growth. And in both cases, policymakers must consider the appropriate role for public sector in regional economic development.

4.1.1.2 Potential Drivers of Economic Development

- ❖ Export base and import substitution: Outside sales bring foreign currency into the region and drive other local economic activity. Foreign currencies leak out of a region when local businesses and households buy "imports" manufactured in another country. While useful as a theoretical concept, this simple economic concept is incomplete. This is mainly because, if export sales and import substitution were the only sources of growth, the world economy would not grow without export sales to other planets(Keller and Yeaple, 2005;Markusen,1997; Onyeiwu and Shrestha,2005;Rweyemamu,1987).

- ❖ Productivity: An expansion of a region's wealth can occur in the absence of any decrease in imports or increase in exports if productivity rises. Here, growth comes from expanding the production possibilities frontier – what can be produced with a given level of labour, materials, and equipment(Campaand Mauro, 1999).

- ❖ Specialization and trade: A region concentrates on producing its most efficient economic activities, earns income from those activities, and then uses that income to import goods and services that are the specialties of other regions(Morisset,2001).

- ❖ Place and space: The implications of geography affect the spatial distribution of economic activity as businesses balance access to consumer markets and production inputs (for example, labour and materials) against costs for land and transportation(Kellerand Yeaple,2005).

❖ Human capital and innovation: The skills, knowledge, and ideas that people bring to the workplace can drive productivity improvements and economic growth(Mendozaand Oviedo, 2006).

❖ Financial capital: Increased private investment – made in response to existing market demand or emerging opportunities – creates new jobs, which increase local income, which leads to greater local demand for goods and services, which in turn leads to more private-sector investment and continues the cycle of growth(Konings, 2001;Morisset and Pirnia,2001).

❖ Entrepreneurialism: Risk-taking entrepreneurs are needed to take the ideas, labour, equipment, and materials and turn them into business activity(Ajayi,2006;Alesina, Campante and Tabellini,2008;Alfaro and Charlton,2009).

❖ Clusters or Agglomeration: Businesses may cluster to take advantage of access to buyers or inputs into the production process, including skilled workers, specialized supplier firms, production technologies, and natural resources(Sornarajah,2004).

❖ Product Life Cycles: Regional growth may be affected by the "life cycle" of a product as it moves from the start-up phase to standardized, or mass, production(Gugler and Brunner,2007;Holland and Pain,1998).

4.1.2 Sources of funding for economic development

Economic development activities are undoubtedly one of the major ways accountable for substantial national governments' budgets throughout the world. Hence, both developed and developing countries must seek sources of funding for economic development(Bulan,2001). This is mainly because economic development programmes success is mainly dependent on their sufficient financial provision(Kokko,2003;Morisset, 2001 ;Persson and Tabellini,2004;Talvi and Végh,2005;UNCTAD,2003). However, the sources of funding for economic development are divided into two broad groups such as domestic or local and foreign sources. The local sources of funding for economic development that can be utilised include taxation, government savings, public borrowing and inflationary financing or deficit financing(De Mello,1997). On the other hand, foreign sources of funding for economic development at the disposal of government include grants or donations, external loans and private foreign investment where grants and loans are the main

foreign sources of funding for economic development through the public sector while private foreign investments are crucial in funding economic development through the private sector. Each of these sources of financing has their benefits and social costs depending on the determination of the upper limit for any source of financing used in order to ensure that they are not costly at the margin (Easson, 2001 ; Hartman, 1985). Therefore, in order to ensure tremendous reduction in the associated marginal social costs through an optimal combination of various sources of funding for economic development. Moreover, since economic development financial requirements are enormous, all the available sources of funding must have their limits allowing each to be used as far as possible. Thus, the choice is between the various sources of funding to be used in order to achieve an optimal combination, but not between which source of financing is to be used. This necessitates the use of Law of Substitution in order to determine the optimal combination of all sources of funding.

In figure 3 below, the three curves (1-1, 2-2, and 3-3) highlights the marginal social costs of the available sources of financing for economic development such as taxation, borrowings as well as deficit financing in a respective manner. Taxation involves disincentive and less disposable income. Borrowing involves less private foreign investment and consumption while deficit financing involves redistribution of income and inflation (Bulan,2001;Easson,2001;Hartman,1985;Hines,1996). The rising curves of taxation and borrowing indicate marginal social costs are rising too, while an initial fall of marginal costs is shown by the deficit financing curve followed by since it enables utilisation of idle resources followed by a drastic rising depicting its subsequent inflammatory impact as a result of surpassing its safe limit. Therefore, from the curves in figure 3 below an optimal combination of sources of financing can be determined.

Figure 3: Optimal combination of sources of finances
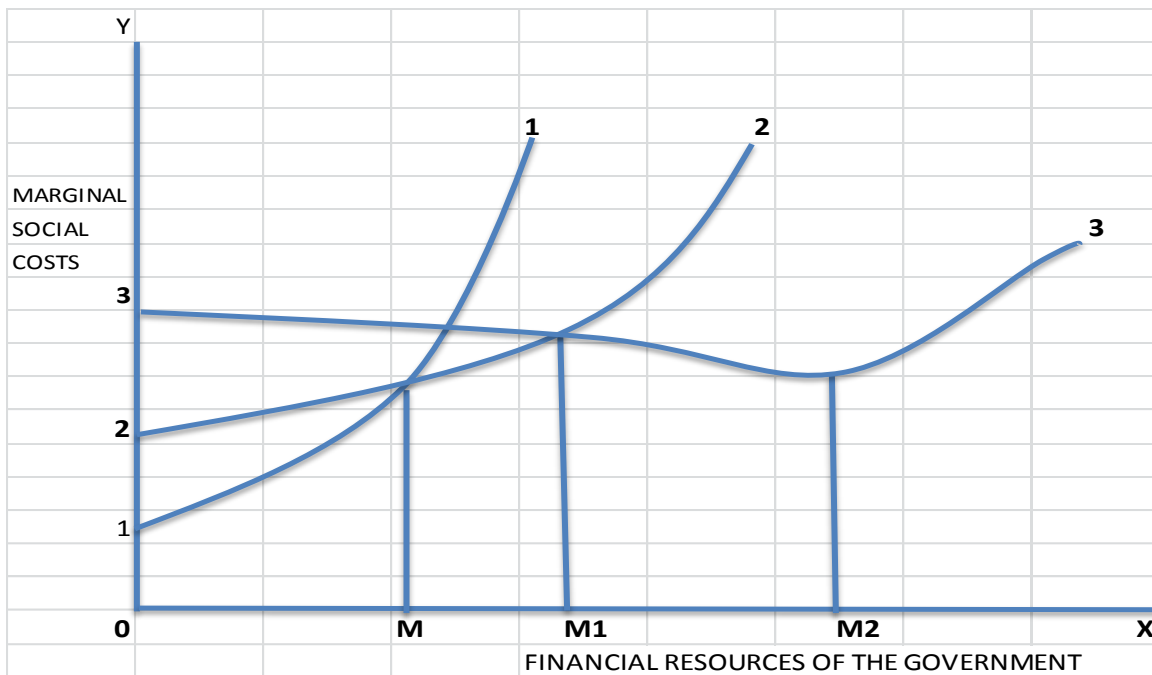
Sours :Bulan, 2001

This indicates that both local and foreign sources of funding for economic development have their own importance and place in the development of a country's economy. Thus, it is essential to always formulate policies that are specific and appropriate for each source of funding which should be fully implemented for the desired economic development to be achieved. Therefore, it is necessary to conduct an analysis of each of the different sources of funding in order for their usefulness in funding economic development to be ascertained.

4.1.2.1 Local sources of financing for the economic development

4.1.2.1.1 Taxation

Taxation is among the oldest sources of funding economic development. Though, as time continued to pass many other local sources of funding have emerged, it is still true that taxation constitute the largest source of government revenue(OECD, 2007;Riley, 2006;Yarbrough and Yarbrough,2002). Apart from taxation leading to revenue generation for the government, taxation policies also have the potential of influencing economic development(Easson, 2001 ; Hartman,1985 ; De Mello,1997).For example, high taxation rates discourage foreign investors as well as decreasing the level of income. This may

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increase government revenue in short-run, but I long-run this have detrimental effects to economic development. There are two types of taxes such as direct taxes (taxes on income; profits; property; wealth) and indirect taxes (taxes on production; trade and consumption of goods and services).

4.1.2.1.2 Public borrowing

This constitutes a substantial amount of local finances to fund economic development and it involves voluntary lending of money by institutions and people to the government. The borrowed money is however paid back with interest(OECD,2007;Riley,2006;Yarbrough and Yarbrough,2002). However, public borrowing faces three major challenges such as the creditworthiness of the government determined by political and economic stability which is often wanting among developing countries making people to be not interested in lending money to the government. Government interest rates on borrowed money are also lower than those offered in the private sector leading to further disinterest in lending to the government; and lastly in cases of inflation (common phenomenon in developing countries) few people are interested in lending and saving due to the envisaged fall in the value of their money(OECD,2007;Riley,2006;Yarbrough and Yarbrough,2002). Moreover, public borrowings are mainly obtained from small savings by individuals and market loans mostly from rich people, non-banking and banking institutions upon purchasing government securities mostly bonds.

4.1.2.1.3 Government savings

Government savings though not very common in developing countries, they constitute a considerable source of finances in developed countries. The saved money is likely to be used in promoting economic development(OECD,2007;Riley,2006;Yarbrough and Yarbrough,2002). Moreover, another form of saving is obtained from surpluses of public enterprises where public savings is increased through increased surpluses or profits of the public enterprises. Though many public enterprises in developing countries rarely make profits, adoption of technology and increased efficiency will make them to tremendously improve their profits or surpluses which will then be directed to economic development programmes(OECD,2007;Riley,2006;Yarbrough and Yarbrough,2002).

4.1.2.1.4 Deficit financing

Deficit financing forms another crucial local source of funding for economic development. This is an intentionally created gap between the revenues and expenses of the government or a deliberatively created budgetary deficit (OECD,2007;Riley,2006;Yarbrough and Yarbrough,2002). The created gap is then filled through government borrowing from all public borrowing sources such as individuals, commercial banks, non-banking institutions and the central bank. This ensures that idle savings in a country are put to work thus making them active in order to increase output and employment eventually leading to economic development (Bulan, 2001 ; Easson,2001 ;Hartman,1985;Hines, 1996).

4.1.2.2 Foreign sources of financing the economic development

4.1.2.2.1 Foreign grants

Foreign grants come in form of gifts (physical things) or money (foreign exchange) and they usually don't come with the burden of repayment or interest charges. From the perspective of the grant receiving country, this is definitely the best form of funding economic development because there are no costs involved (Alfaro and Charlton,2009 ; Blomstrom and Kokko,1998).

4.1.2.2.2 External loans

This is another foreign source of financing for economic development where developing countries often borrow from the developed ones from abroad implying that the funds are transferred from the savings of a developed country to a developing country in order to support economic development. These loans are either bilateral or multilateral. When a country uses this source of funding it comes with the burden of serving the debt together with the charged interest(OECD, 2007;Riley, 2006;Yarbrough and Yarbrough,2002).

4.1.2.2.3 Private foreign investments

The official foreign sources of funding for economic used to finance public sector development are the foreign grants and external loans. However, private foreign investments are required in to develop the private sector so that a balanced economic development can be

achieved(OECD, 2007;Riley, 2006;Yarbrough and Yarbrough,2002). In most cases, private investments originating from foreign countries bring in the capital together with technical and managerial skills to the host country from abroad. Apart from the above mentioned advantages private foreign investments also have the advantage of providing the much needed resources to the host country such as scarce raw material, special production techniques, and others that are essential for a country's economic development(OECD, 2007;Riley, 2006).

4.2 Foreign direct investment concept and forms

4.2.1   The foreign direct investment

Foreign direct investment (FDI) is a very significant phenomenon on international trade today and plays an important and continuously growing role in global business. FDI is the investment made by a particular country in another mostly through MNCs based in the former country(KOKKO,2003). FDI has the potential of providing a company with new markets and channels of marketing, access to new technology, cheaper production facilities, as well ascheap labour and resources(Morisset and Pirnia,2001).For the host country receiving FDI, it can act as a source of capital, processes, new technologies, management skills, and organizational technologies, and as such have the potential of providing a strong impetus to the host country's economic development.

In its classic definition, foreign direct investment is defined as the physical investment made by a company from one country into factory or industry building in another country(Calderon and Schmidt-Hebbel,2008).   The FDI in buildings, equipment and machinery is different from portfolio investment, regarded to be an indirect investment(Dunning,2002).Given the rapid changes and growth in the patterns of global investment over the recent past, the definition of foreign direct investment has been broadened so that it encompass the acquisition of a long run interest in the management of an enterprise or a company outside the home country of the investing company(Clark,2000;Frankel, 2011). As a result, in modern international market definition of FDI may take many forms including construction of a production facility, a direct acquisition of a foreign firm, or strategic alliance with a company that is locally based with input of technology from the attendant, or investment in a joint venture as well as licensing of intellectual property(Aitken and Harrison,1999;Ajayi, 2006;

Akinkugbe, 2003;Alesina and Perotti,1996;Alfaroand Charlton,2009;Basu and Srinivasan,2002).

FDI has taken a very crucial position over the past decade as well as playing a major role in the business internationalization(Phillips and M. Obwana,2000). The scope, size, and methods of FDI have experienced profound changes as a result of reacting to advancements in production technology, increasing liberalization of regulatory frameworks that govern investment in enterprises, as well as the tremendously changing capital markets(Tanzi .V and Zee .H,2000).Moreover, declining costs of global communication and the growing new information technology systems have made the work of managing FDIs far much easier than in the past. The enormous changes in investment and trade policies and the global business regulatory in the past decade, including tariff liberalization and trade policy, acquisition in many nations and easing of FDI restrictions, as well as the privatization and deregulation of many companies, have significantlyinfluenced expanded role of FDI in the past decade(Aitken and Harrison,1999;Ajayi, 2006; Akinkugbe, 2003;Alesina and Perotti,1996;Alfaroand Charlton,2009;Basu and Srinivasan,2002).

Foreign direct investments are usually driven by internationalization, mergers and acquisitions of production operations in a wide range of companies, thereby making them an indispensable part of international trade(Alesina and Perotti,1996). FDI proponents point out that the investment flow exchanges benefits both the host country and the home country, but opponents of FDI reiterates that multinational conglomerates have the potential of wielding great pressure over weaker and smaller economies thereby driving out much local competition. FDI represents a chance to small and medium sized companies to big multinational corporations or conglomerates to have a more active role or participation in international business activities (Aitken and Harrison,1999;Ajayi, 2006; Akinkugbe, 2003;Alesina and Perotti,1996;Alfaroand Charlton,2009;Basu and Srinivasan,2002).

For small and medium sized companies, FDI represents an opportunity to become more actively involved in international business activities. Over the last two decades, there has been considerable change in the classic definition of FDI. However, this classic definition change notion must be maintained in the proper context. For example, it can be clearly stated that, over 2/3 of FDI is made in the form of equipment, machinery, fixtures, and buildings. In addition, an overwhelming percentage of FDI globally is controlled by larger multinational

conglomerates and corporations(Ayanwale,2007 ; Brewer,2004). Furthermore, the advent of the Internet, loosening of restrictions to FDI in many markets, increased role of technology, as well as continued decrease in communication costs implies that newer forms of FDI will in the future play asignificant in international business(Charlotte,2004 ; Dunning,2002; Hines,1996). Therefore, many governments, especially in developed and industrialised nations, give FDI a priority and also pay very close attention it since FDI inflows and outflows have a significant impact on their economies. Hence, an effective monitoring of FDI inflows and outflows data is very crucial in determining the impact of FDI on the overall economy as well as acting as a helpful factor in the evaluation of industry segments(Osman,2000 ; Somarajah,2004).

4.2.2 Forms of foreign direct investment (FDI) and his significant

There are three major forms of FDI discussed below such as horizontal FDI, vertical FDI and export-platform FDI.

4.2.2.1 Horizontal FDI

HorizontalFDI are activities conducted by companies in order to expand their operations into another market. Horizontal FDI is an investment made by a multinational company in different nations(Akinkugbe,2003 ; Bowles,2004). The horizontal FDI is made for conducting the similar business operations as already conducted by the company at home country. For example, if a company manufacturing soft drink makes its plant outside its national borders then this is horizontal FDI(Campa and Mauro,1999)The results of horizontal FDI are the expansion of the parent company by bringing FDI to other economies(Gugler and Brunner,2007).

4.2.2.2 Vertical FDI

Vertical FDI occur when a multinational company makes a decision to build or acquire an operation that either fulfils the role of a distributor (forward vertical FDI) or the role of a supplier (backward vertical FDI).Vertical FDI occurs when a firm uses FDI to move downstream or upstream in different value chains i.e., when firms perform stage-by-stage value-addition activities in a vertical fashion in a host country.Companies can also make vertical FDIs to increase sales and grow the business(Phillips and M .Obwana,2000 ; UNCTAD,1999).

Companies seeking to enter into a backward vertical FDI typically seek for the improvementof the supply of certain key components or the cost of raw materials. For example, steel is one of the major materials used to manufacture car. Therefore, a car manufacturer would prefer to make steel be as cheap as possible, but steel prices are likely to fluctuate dramatically on the basis of overall supply and demand. Furthermore, the foreign steel supplier would prefer to sell steel for as high as possible in order to please its owners or shareholders. If the car manufacturer acquires the foreign steel supplier, the car manufacturer would no longer need to deal with the steel supplier and its market-driven prices(Vemon,1996).

On the other hand, the need for a forward vertical FDI stems from the problem of finding distributors for a specific market. For example, assume that the before-mentioned American car manufacturer wants to sell its cars in the Japanese auto market. Since many Japanese auto dealers do not wish to carry foreign brand vehicles, the American car manufacturer may have a very difficult time finding a distributor. In this case, the manufacturer would build its own distribution network in Japan to fulfil this niche.

4.2.2.3 Export-Platform FDI

Export-platform FDI is FDI motivated by a desire to export rather than to serve the local market. Vertical FDI becomes export-platform FDI where the exports are sent back to the home market(Rweyemamu,1987). However, there is an increasing trend toward export-platform FDI where the exports are sent to third markets(Shukri Ghanem,2010).

The rise of trade blocks with low internal trade barriers but higher external barriers may contribute to this trend. Multinationals are establishing production subsidiaries within a trade block and using that plant to serve the entire block. To the degree that the host country is small relative to the overall size of the trade block, the vast bulk of production will be exported to other countries in the trade block.

4.3 The importance of foreign direct investment in developing economies

4.3.1 The impact of foreign direct investment on the national economy

Although FDI flows traditionally took place between countries that are developed, developing countries have increasingly begun to occupy a considerable share over the past three decades(Alesina, Campante and Tabellini,2008;Blomstrom and Kokko,1998).Nowadays, developing countries account for about 24 per cent of total FDI flows and FDI has become one of the most significant sources of external finance for developing countries as a group, moreimportant than portfolio investment, commercial loans and official developmentassistance(Ayanwale,2007). However, since FDI flows have tremendously grown in volume, they have also become more extensively dispersed among host (recipient) and home (outward investor) countries. Developing countries' share in total FDI inflows increased from 26% in 1980 to 37% in 1997, and their share in total FDI outflows increased from 3% in 1980 to 14% in 1997(UNCTAD,2005; World Bank,2006) . Firms whose operations are based in industrial or developed countries are still the primary source of FDI to developing countries, but direct investment that originate in developing countries has tremendously grown over the last three decades.

Among developing countries, though, the distribution of world FDI inflows is uneven. In 1997, for example, Latin America and the Caribbean, 14 percent; developing Asia received 22 per cent; and Africa, 1 percent. In relative terms, however, the picture looks different: expressed as a ratio of gross fixed capital formation, FDI inflows to Africa were 7 percent in 1996, compared with 13 percent for Latin America and the Caribbean and 7 percent for developing Asia. In other words, inflows to Africa have a greater impact on the countries of that continent in relative terms than the absolute figures suggest(Alesina, Campanteand Tabellini,2008;Wells,1972).

Access to FDI can supplement domestic savings, which are usually low indeveloping countries, and fill the shortfall in capital needed to finance economicgrowth and development(Yin,R,1994) Moreover, while the provision of additional capital is themost cited contribution to development in the host country, FDI can also work througha number of other, sometimes even more important, channels:

❖ FDI can lead to the transfer of new technologies and skills, upgrading localtechnological capabilities and thereby increasing competitiveness;Not only can FDI transfer production technology, but, perhaps more important, it is also a means of transferring skills, innovative capacity, and organizational and managerial practices between locations

❖ FDI can lead to new employment opportunities, often with a content in terms ofskills, value-added and remuneration which is higher than those prevalent in the local economy;

❖ Transnational corporations (TNCs) increase access to world markets for goodsand services produced in the host country; domestic companies may becomesuppliers to global TNCs and integrate into global production networks; this facilitates access to international marketing networks. The first to benefit are enterprises that are part of transnational systems (consisting of parent firms and affiliates) or that are directly linked to such systems through nonequity arrangements,

❖ Entry of foreign companies into a domestic market can increase competition,thereby ensuring that local consumers have access to high quality goods andservices at competitive prices;The greater the supply and distribution links between foreign affiliates and domestic firms, and the stronger the capabilities of domestic firms to capture spillovers (that is, indirect effects) from the presence of and competition from foreign firms, the more likely it is that the attributes of FDI that enhance productivity and competitiveness will spread. In these respects as well as in inducing transnational corporations to locate their activities in a particular country in the first place, policies matter.

❖ FDI, in particular when occurring in the form of a merger or acquisition of localfirms by foreign companies, can help to restructure domestic industry andincrease its competitiveness, e.g. by exploiting economies of scale.

❖ FDI has become an important source of private external finance for developing countries. It is different from other major types of external private capital flows in that it is motivated largely by the investors' long-term prospects for making profits in production activities that they directly control.

4.3.2   The experiences of some developing countries with FDI

4.3.2.1 Ghana

Ghana is among the largest FDI recipients in Africa and despite liberalisation of investment rules, reduction of trade barriers and improved the business climate there has been a decrease in FDI inflows into Ghana over the recent past contrary to what has been envisaged by the government. Though there was tremendous increase in absoluteFDI inflows in the 1990s, this trend began from a very low level in the preceding decade. Between 1993 and 2005, annual FDI inflows fluctuated between US $50 million and US $250 million(Creswell, 2003;Anyanwu, 1998).In 2006, FDI rose to almost US $450 million. The fluctuations in thelevel of FDI reflect erratic levels of investment and inflows linked to privatisation.As a share of GDP, FDI inflows to Ghana since the mid-1990s were about 1 to 2 per cent. In2006, the year with the highest quantity of FDI inflow, the same share reached some3.4 per cent, which is indicative of a significant increase over recent years. In that year, capitalprovided from foreign sources made up 10.4 percent of total gross capital formation(Asiedu,2002; Campa and Mauro,1999;Djankov and Hoekman,2000; Holland and Pain,1998). FDI inflows can thus be a considerable source of capital. Moreover, despite the recent increase in FDI inflows, FDI levels are low compared to other developingcountries. Since 2000, Ghana has only managed to attract between 0.05 percent and 0.1 percent of total FDI to all developing countries(De Mello, 1997; Hines, 1996).

4.3.2.2 Kenya

The growth in foreign direct investment (FDI) has been phenomenal in the last three decades. Prior to the recent economic and financial crisis, global FDI had risen to an all time peak to reach $1,833 billion in 2007 well above the previous time all high set in 2000 (Gachino,2006; Gachino and Rasiah,2003;UNCTAD, 2005). The production of goods and services by an estimated 79,000 multinational corporations and their 790,000 foreign affiliates continued to expand with their FDI stock exceeding $15 trillion in 2007. Their total sales amounted $31 trillion with value added by foreign affiliates worldwide estimated at 11 per cent of world's gross domestic product employing close to 82 million people(Easson,2001;Charlie,2007;Buckley and Casson,1976; Anyanwu,1998; Alfaro and Charlton,2009;Gachino and Rasiah,2003). Interpretation of these trends are commonly infused with much enthusiasm as growth is believed to be the single most important factor

affecting poverty reduction and therefore FDI is central in achieving this objective, since FDI is considered as a key ingredient for successful economic growth in developing countries.

4.3.2.3 Uganda

The FDI trend in Uganda has been increasing since 1990 and the year 2008 represented a marked rise of FDI to 799 million USD. The trend has continued to steadily grow and in the year 2010 it reached a high of 1.67 billion USD(Pongsiri,2004;Yarbrough and Yarbrough ,2002 ;UNCTAD,2010).

Figure 4: Trends of Uganda's FDI since 1990 to 2010
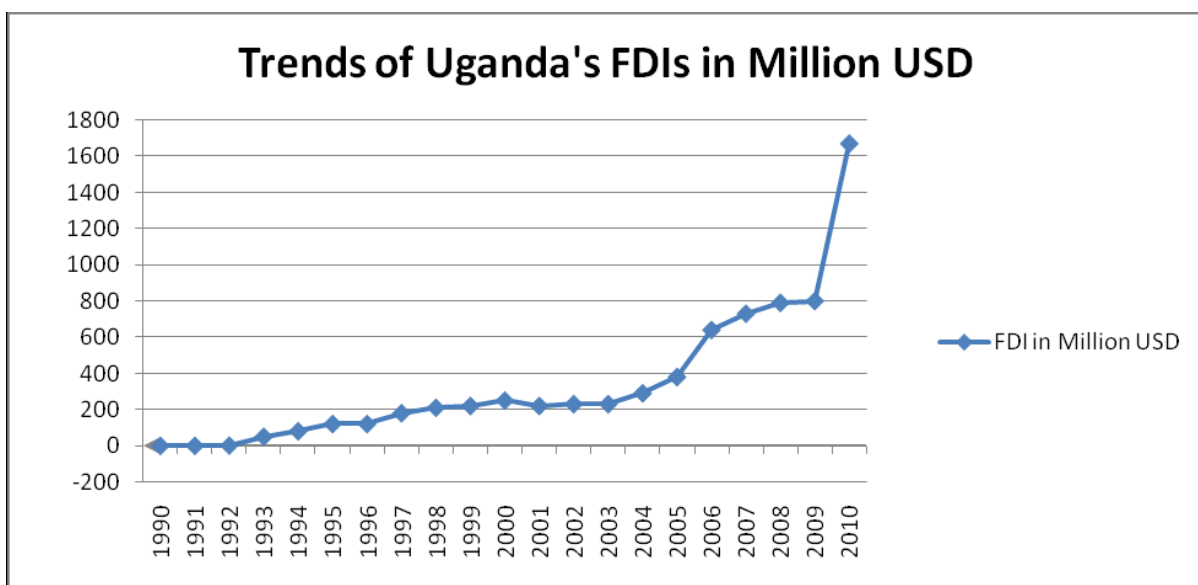
Source: Uganda Investment Authority, 2010

Despite, initial minimal FDI in Uganda the recent trend from 1991 indicates remarkably improving capital inflows leading to significant rise in employment opportunities, due to the increased number of foreign companies that accounted for 38% of the job opportunities(Alfaro,Chanda, Kalemli-Ozcan and Sayek, 2004), while the joint ventures between foreign owned firms and local firms accounted for 24% of job opportunities (World Investment Report, 2008).

4.3.2.4 Malaysia

Malaysia is an important foreign direct investment (FDI) destination due to the deregulation by the Malaysian government in 1986 in conjunction with numerous fiscal incentives which makes the country a favourable destination for many foreign investors(Caves, 2007;Dunning,1998).

FDI flows reached a peak in 1988-1993 as export-oriented foreign multinational enterprises (MNEs) relocated manufacturing production operations to Malaysia to benefit from government incentives, cheap labourand liberal conditions for manufacturing FDI. However, after 1996, as a result of the Asian financial crisis in 1997-1998, FDI flows into Malaysia experienced a significant decrease and subsequently recorded the lowest level in 2001 due to the world trade recession. Moreover, following a steady growth in 2002-2007, there was a dramatic fall in FDI in Malaysia in 2008 and 2009 as a result of the global economic crisis(De Mello,1997;Holland and Pain,1998). However, government efforts, including the Government Transformation Programme,continued liberalization of manufacturing and services, promotion of new key economic areas, and the active role of the Ministry of International Trade and Industry (MITI), led to substantial contribution towards increasing in inward FDI flows in 2010 onwards.

4.3.2.5 Nigeria

In Africa Nigeria is usually the one which receives the largest amount of Foreign Direct Investment (FDI) where FDI inflows have been enormously growing over the last decade: from 1.14 billion US dollars in 2001 and 2.1 billion US dollars in 2004, FDI in Nigeria reached 11 billion US dollars in 2009 according to UNCTAD, making it the nineteenth greatest FDI recipient globally(Morisset,2001;Alesina and Perotti,1996;UNCTAD 2010).Most important sources of FDI in Nigeria have traditionally been in the oil exploration and production. Nigeria receives FDI from countries such as the USA, the UK, China, Italy, Brazil, the Netherlands, France and South Africa(Markusen,1997).

CHAPTER V: THE EFFECTIVENESS OF FISCAL POLICY IN LIBYA IN ATTRACTING THE FOREIGN DIRECT INVESTMENT (FDI) IN THE PERIOD (2000 TO 2010)

5.1 The foreign direct investment in Libya

In the late nineties and early 2000s, Libya began numerous attempts towards reforming the political system and economy. These reforms were marked byinitial stages of economy liberalisation as well as encouraging participation of local and foreign private investors in economic activity. These attempts have been mainly developed in order to encourage attraction of FDI. Therefore, Libyan authorities adopted numerous actions stemming from reform policies, with a purpose of encouraging foreign investors to locally invest in Libya mainly through privatisation of large number of public institutions. Additionally, Libya updated its legislation system by developing new laws that aimed at encouraging and attracting FDI in Libya. However, continued economic and political instability hindered attraction of substantial FDI even though the levels of FDI began to sharply rise compared to the previous decade. Most of the FDIs were made in the oil and natural gas sector as well as manufacturing sector of the economy. Therefore, despite low levels of FDI in Libya at the beginning of the last decade, the levels tremendously increased towards the end of the decade although this was later hampered by the 2011 Uprising which saw Gaddafi overthrown and killed marking the beginning of a new political era spearheaded by the National Transition Council (NTC). This implies that the reforms that had been started to liberalise the economy had begun to bear fruits even though short lived.

Libya is one of most developing countries which stood a better chance of significantly benefiting from FDI because of its suitable geographic location and possession of different natural sources. FDI levels tremendously increased in Libya after oil was discovered in 1958, but adoption of socialism regime, in 1969 after the upheaval foreign direct investments sharply decreased up to mid 2000s when the levels of FDI began to increased after economic sanctions were suspended in addition to adoption of economy liberalisation policies to transform the economy.

Moreover, two economic sanctions on Libya by the US government in 1982 and 1988 respectively as well as the UN Security Council economic sanctions on Libya in 1992 were among the other major factors apart from the economic policies that significantly reduced levels of FDI in most part of Gaddafi regime . These sanctions were imposed due to Libya's participation in terrorism activities as well as production of weapons of mass destruction. These sanctions severely affected the Libya economy leading to economic shrinkage in all economic sectors. Hence, in early 2000s Libyan government had begun attempts to redeem its previous economic prowess by developing policies that liberalised the economy as well as reducing or eliminating most of the market barriers.

5.1.1   Statistics of Foreign Direct Investment (FDI) in Libya

The foreign direct investment levels can be observed from several indicators that are obtainable from online databases of the World Bank, International Monetary Fund and Central Bank of Libya. However, foreign direct investment can be classified into three major categories such as: FDI net inflows as a percentage of the GDP; FDI net outflows as a percentage of the GDP; and FDI net as a balance of payment in terms of US dollars.

5.1.1.1 Foreign direct investment, net inflows (% of GDP)

At the beginning of last decade Libyan foreign direct investment, net inflows (% of GDP) were relatively low particularly recording a negative value in 2001. However, from mid 2000s the trend took another turn and levels of FDI began to increase even though severely affected in 2009 may be as a result of global recession. The highest value of Libyan foreign direct investment, net inflows (% of GDP) over the last decade was 6.143% in 2007, while the lowest value which is negative was -0.39% observed in the financial year 2001. The foreign direct investment, net inflows (% of GDP) can be defined as the net inflows of foreign investments towards acquisition of a lasting management interest in a business enterprise whose operations are based in an economy other than the home country economy of the investor. It can also be regarded as the sum of reinvestment of earnings, equity capital, other long-term capital highlighted in the balance of payments, as well as short-term capital which is also indicated in the balance of payments.

Table 1: Foreign direct investment, net inflows (% of GDP)

Year	FDI net inflows as (% of GDP)
2000	0.366
2001	-0.390
2002	0.661
2003	0.545
2004	1.07
2005	2.28
2006	3.747
2007	6.143
2008	3.907
2009	5.63
2010	2.65

Source: UNCTAD, 2011

Figure 5: Foreign direct investment, net inflows (% of GDP)
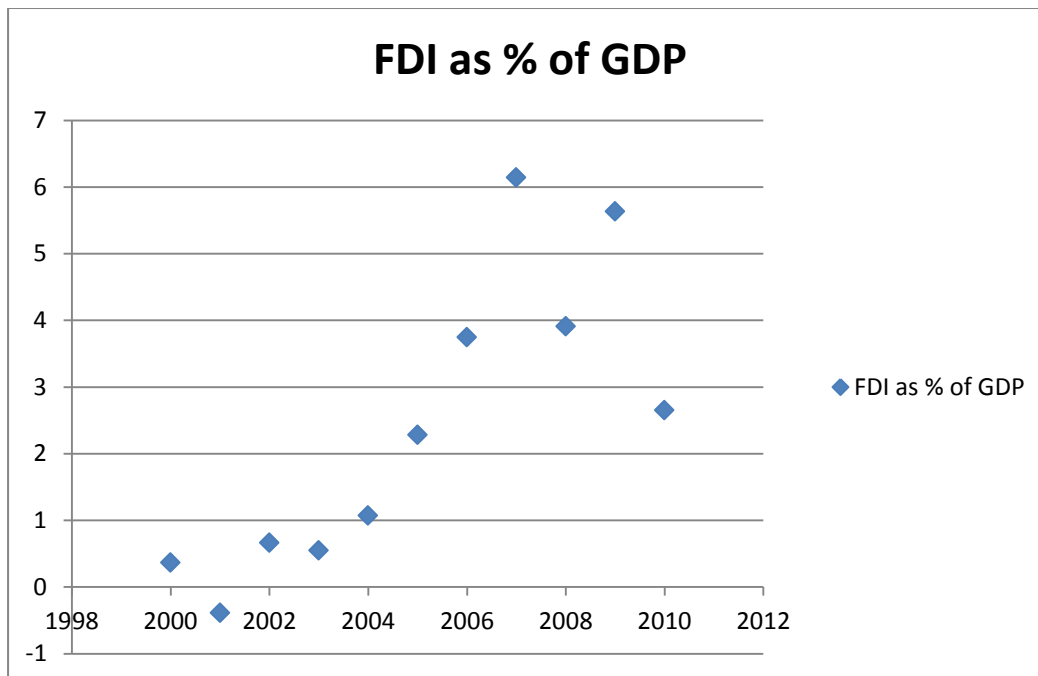
Source: UNCTAD, 2011

5.1.1.2 Foreign direct investment, net outflows (% of GDP)

Libyan foreign direct investment, net outflows (% of GDP) at the beginning of last decade were relatively low particularly recording a negative value in 2002. However, from mid 2000s the levels of FDI began to increase even though severely affected in 2009 may be as a result of global recession. The highest value of Libyan foreign direct investment, net outflows (% of GDP) over the last decade was 7.23% in 2008, while the lowest value which is negative was -0.62% observed in the financial year 2002. The foreign direct investment, net outflows (% of GDP) can be defined as the net inflows of foreign investments towards acquisition of a lasting management interest in a business enterprise whose operations are based in an economy other than the home country economy of the investor. It can also be regarded as the sum of reinvestment of earnings, equity capital, other long-term capital highlighted in the balance of payments, as well as short-term capital which is also indicated in the balance of payments. Figure 5 below shows a series of net outflows of investment from the reporting economy (which in this case is Libyan economy) to the rest of the world and it is expressed as a percentage of the country's GDP.

Table 2: Foreign direct investment, net outflows (% of GDP)

Year	FDI net outflows as (% GDP)
2000	0.254
2001	0.513
2002	-0.62
2003	0.240
2004	0.859
2005	0.281
2006	0.86
2007	6.29
2008	7.23
2009	1.98
2010	3.78

Source: UNCTAD, 2011

Figure 6: Foreign direct investment, net inflows (% of GDP)
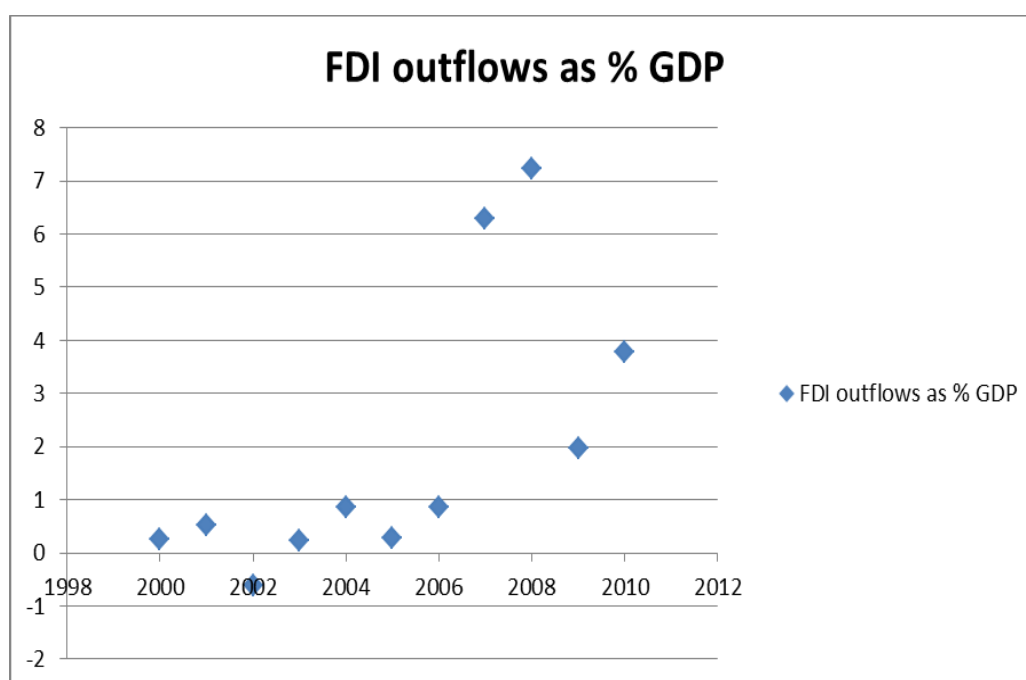
Source: UNCTAD, 2011

5.1.1.3 Foreign direct investment, net(BoP, Current US$)

Foreign direct investment, net (BoP, Current US$) is expressed in terms of US dollars because it indicates the actual foreign direct investments made in a country excluding the foreign direct investment net outflows. The value of Libyan Foreign direct investment, net (BoP, current US$) has been fluctuating since the first foreign investors made investments in Libya. However, a consideration of GDP percentages of FDI (net inflows) and FDI (net outflows) between 2000 and 2010 (case study period) it is evident that FDI, net (BoP, Current US$) has been significant due to low values of GDP percentages of FDI (net outflows) compared to those of FDI (net inflows) indicating a considerable difference with exception of 2007 and 2008 when GDP percentages of FDI (net outflows) were significant showing a values of 5.48 and 6.32 respectively. The highest value of Libyan foreign direct investment, net (BoP, Current US$) over the last decade was $1,776,900,000.00 in 2008, while the lowest value was $43,000,000.00observed in the financial year 2000.The foreign direct investment, net (BoP, Current US$) can be defined as the net inflows of foreign investments towards acquisition of a lasting management interest in a business enterprise whose operations are

based in an economy other than the home country economy of the investor. It can also be regarded as the sum of reinvestment of earnings, equity capital, other long-term capital highlighted in the balance of payments, as well as short-term capital which is also indicated in the balance of payments. Figure 6 below shows a series total net, that is, net FDI in the reporting economy (Libyan economy) from foreign investors excluding net FDI (to other parts of the world) by the reporting economy.

Table 3: Foreign direct investment,net(BoP,Current US$millions)

Year	Net FDI (PoB,Current US$ millions
2000	43
2001	308
2002	281
2003	80
2004	71
2005	910
2006	1590
2007	756
2008	1776.9
2009	206
2010	938

Source: UNCTAD, 2011

Figure 7: Foreign direct investment, (Current US$ in millions)
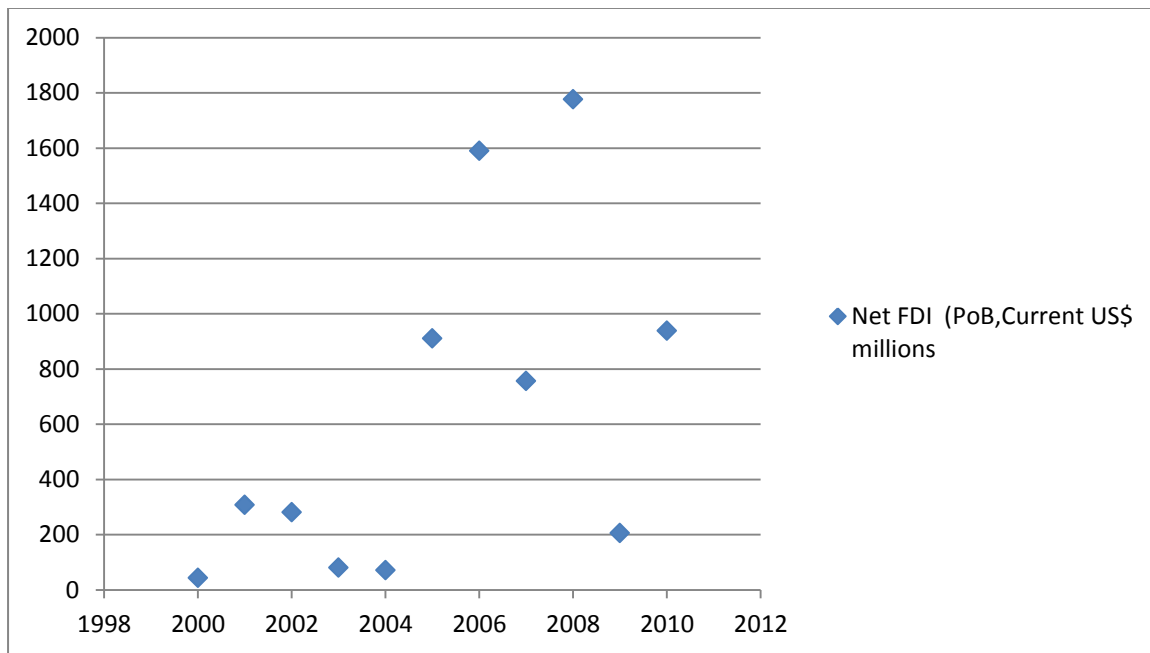
Source: IMF and WB, 2011

5.2 The reality of fiscal policy in Libya

5.2.1 Public spending policy in Libya

When the public spending of the Libyan government is considered there is a need to increase and improve theefficiency. This is mainly because presently, noninvestmentspending levels are high that meaning they will not yield any economic benefits both medium and long-term. For example, more than 64 per cent of public spending in Libyagoes towardssalaries, subsidies as well as other related programmes. However, public spending in Libya constitutes of two major components such as consumption expenditures and capital expenditures. In Libya, public consumption stood at 16.1%ofGDP in 2006 whereas private consumption 24%. However, public investment which was 10.9% wasmuch greater compared to private investment which accounted for only 2.2%. This is a clear illustration of the important role of public spending both government investment and consumption in growth, particularly when 99% ofexports are obtained from the oil and gas sector which is predominantly controlled by the government.

Moreover, optimal or appropriate level of publicspending in a country is hard to define since it is dependent on a multitude of factors. As Libya's public funds allocation is greatly

distorted as a result of extra-budgetary spending that is substantial, excessive decentralisation and indirect subsidies, thepotential spending efficiency gains also seem appreciable. However, when there is improved efficiency in public spending, this would allowbettermanagement of budgetary deficit in the non-oil/gas sector,which is crucial for ensuring there is macroeconomic stability and public spending sustainability in view of theoil and gas revenue unpredictability.

5.2.2 General revenue policy in Libya

Most of the general revenue for the Libyan government are obtained from the hydrocarbons, and in the recent past particularly in 2007,Libya has been enjoying higher oil prices leading to further liberalised foreign trade and easedexchange controls. Moreover, the economic growth of Libya has been driven by the government investment and spending, along with exports that have recently been independent of or diversified from the energy sector. For instance, the real GDP growth since 1992 has always been heavily reliant on oil prices and export earnings approximated at 5.6% in 2006, 6.8% in 2007 and 8% in 2008. Dependence on revenues from the oil and gas sector has continued to grow, where oil andgas sector has been providing more than 99% of all export earnings as well as 78% of government revenue in 2007. The enormous dependence of Libyan economy on oil and gas sector makes the economy vulnerableto changes in prices of the two commodities at global market, but when the prospects are good,substantial funding will be attracted from government investment programmes. Moreover, the oil and gas sector has been predominating Libya's economic growth, contributing 74% of GDP in 2006, and in 2001 it had accounted for 62.5% of GDP.

Moreover, the government has been undertaking projects aimed at diversifying the economy by making it less reliant on oil and gas sector. However, the efforts to diversify theeconomy have not yielded tangible results,but these efforts remain an important part of the new economic strategy by the country. Activity in the private sector may partially explain the non-oil/gas sector recovery, butinfrastructure (excludingconstruction) and productive services have accounted for half the non-oil/gassector's growth where these sectors heavily depend on government investment as well as other national budget linked activities.

 The traded goods sector(excluding gas and oil) have been contributing very little to country's economic growth, indicating diversification of the Libyan economy has actually not been achieved. For instance, mining, agriculture, and manufacturing sectors of the economy

accountedfor only 0.29, 0.24 and 0.11 percentagepoints respectively which in 2006 were about 10% of GDP growth.

5.2.3 General budget in Libya

Increasing oil prices have made Libyan budget deficit to dramatically change into surplus. The 2006 national budget surplus was 39% of GDP and 66.35 of GDP was obtained from oil and gas revenue, compared with just 5.4% that the non-oil/gas sector contributed.Higher oil prices have been instrumental in increasing the surplus, and the country had been recording an overall budget surplus for the last decade. However, apart from oil and gas sector other sectors that bring public revenues include non-oil/gas (7.5% of totalrevenue), mainly customsduties (19.3%), sales tax (36.7%), and other income taxes (44%). More, budget details are outlined in Table 4 below:

Table 4: Public Finances (percentage of GDP)

	2003	2006	2007	2008	2009	2010
Total revenue and grants	49	62.4	61.5	65.6	60.7	62
Tax revenue	2.1	2.5	2.7	3	5.4	4.8
Oil revenue	44.8	57.5	55.7	62.3	55	56.9
Grants	-	-	-	-	-	-
Total expenditure and net lending (a)	39.5	31	34.8	39.6	55.3	53.4
Current expenditure	31.1	13.4	13.2	16.2	26.8	25.9
Excluding interest	31.1	13.4	13.2	16.2	26.8	25.9
Wages and salaries	8.3	6.6	7.8	6.7	11	10.3
Interest	0	0	0	0	0	0
Primary balance	9.5	31.4	26.7	25.9	5.4	8.7
Overall balance	9.5	31.4	26.7	25.9	5.4	8.7

Source: African Economic Outlook, 2012

5.3 The effects of fiscal policy on the investment climate in Libya.

5.3.1   The evolution of the investment climate in Libya

The economy and investment climate in Libya has undergone tremendous evolution through significant movement toward global markets, particularly by privatising of the enterprises that were previously state-owned. Nowadays, after a more than three decades of public sector reliance, Libya has pursued an aggressive process of public sector privatisation. In late 1980s, in the wake of economic sanctions, Libya began its initial wave of reforms to the investment climate. These reforms included introduction ofself-management enterprises that created cooperatives, and in less than one year, about 140 medium- and smallscaleenterprises had already been created. Similarly, the ban against the retail trade that had been there was lifted, and it allowed re-opening of private shops. Moreover, in September 1988, the monopoly of the state on exports and imports was abandoned, in addition to subsidieson flour, salt, tea, and wheat. Resumption of private practise by professionals was allowed, even though the fees continued to be set by the government.

There were also numerous legislations to improve the investment climate and the number and range of measures that were embraced were suggestive that theadopted legislation was on the way to making Libyan economy liberalised, one of the most dramatic changes that had been experienced in the region's history particularly involving economic reforms in the 1980s and 1990s. This was a positive step towards ensuring a favourable investment climate is established to facilitate economic growth. In effect, liberalisation of the market the investment climate began to gradually improve giving the private sector more space to operate. This led to considerable investment by domestic investors even though many others were reluctant to open up their businesses. As a result of this economic revolution, by mid-1990s is was possible to access the kind of food supplies and consumer goods that had previously been on supply in Libya before the revolutionary decade.

Moreover, since 2003 after the suspension of US economic sanctions marked another era of tremendous evolution in the economy and investment climate in Libya. Thus, the period between 2003 and early 2011 marked the most significant attempts by the Libyan government to reform its economy. The country was aggressively pursuing economic liberalisation andreform in the attempts of opening up the market for both local and foreign investors through creation and improvement of investment climate. In particular, in the year

2000 the country announced that it was undertaking measures for further opening up of its economy so as to attract more foreign capital.For that purpose, the exchange rate was unified where the Libyan dinar was pegged to the IMF's Special Drawing Rights. This was meant to increase Libyan firms' competitiveness on global market as well as helping the country to attract foreign investment. In March 2003, there was adoption of legislation by the General People's Congress that was meant to further spur liberalisation and reform in the country's economy and investment climate. There was continued privatisation of a large number of the state-owned economic enterprises in the country after an admission of the failure of the country's public sector necessitating its abolishment. Privatisation of more public enterprises meant there would a level playing field and fair competition in the market thereby improving investment climate in the country.

Moreover, in the country's desperate measures to improve the economy and investment climate, the country accepted the Article VIII obligations of the IMF'sArticles of Agreement after many year of shunning advice from international players in the economy. The government undertook measures to, improve macroeconomic management, and embrace wide structural reforms as well as removing price subsidies and trade barriers. Moreover, these attempts did not immediately achieve the envisaged results since despite encouraging significant investment from domestic investors; it still faced challenges attracting foreign investors in other sectors other than the oil and natural gas sectors. However, despite that sanctions that led to economic and political hardships, the government still had a clear objective of what it wanted to achieved from such reforms aimed at liberalising the economy and improving investment climate as it was note at one time by the Prime Minister.

Despite this inevitable slowdown in the implementation of economic reforms aimed at liberalising the economy, Libya's economy continued to indicate gradual but incremental improvements towards achieving efficiency through improved investment climate and the FDI levels had began to gradually increase. However, by end 2010, tremendous progress had already been achieved in the country towards creation of statutes that were necessary for the implementation of some of the reforms.Some of the recent reforms in Libya that led to improved investment climate included: creation of the Tripoli stock market in 2007 as a crucial component of hastening public companies privatisation; creation of a banking system that was more streamlined thorough the banking system privatisation and foreign investment as major stake holder beginning in 2007; reducing the minimum investment threshold to $1

million from $50million in 2006; creation of the Libyan Investment Authority which acted as the sovereign wealth fund in the country; establishment of the Privatization and InvestmentBoard in 2009 for streamlining business license applications in order to improve investor confidence; introduction of new income tax flat rates of 20 and 10 % for corporations and individuals respectively; as well as creation of an Export Promotion Centre aimed at boosting foreign trade from sectors of the economy. This has greatly contribute towards ensuring favourable investment climate is established.

Furthermore, by 2010 there was a further plethora of stipulations that regarded CommercialLaw, Income Tax Law, Labour Law,Stock Market Law, Customs Law, Land Registry Law, Communications Law, and laws that regulate the Libyan Investment Authority activities had been adopted. Moreover, diversification of Libyan economy to reduce overreliance on hydrocarbons meant that infrastructural developments would be undertaken to improve investment climate.

5.3.2 Tax policy and investment climate

Domestic and foreign tax policies are the one which affect the incentive to engage in, and the means of financing it. This is mainly because the tax policy adopted by a country may make the investment climate to be very unfavourable or favourable thereby attracting significant FDI. In particular, the Libyan tax policy had been prohibitive to attract both domestic and foreign investments where exorbitant tariffs, import duties and corporate tax rates were charged. This increased effective tax rate resulting to significant reductions in the business profitability. However, in the wave of economic reforms most of the prohibitive tax policies that were initially used by the Libyan government were reviewed in order to allow liberalisation of the market as well as attracting substantial FDI into the country. Flexible and convenient tax policy adopted by the Libyan government since 2005 has been favourably for many investors who find the investment climate relatively good hence attracting more FDI.

CHAPTER VI: METHODS AND METHODOLOGY

6.1 Methods and methodology

In the attempts of ensuring that this case study was conducted in a successful manner adoption of the appropriate research methods was necessary, and in this case two study methods were adopted such as the case study and descriptive research designs. The researcher made the decision to combine the two research designs in order to make sure sufficient data concerning foreign direct investments (FDI) and fiscal policy parameters in Libya was collected where the case study research design was very instrumental in facilitating the entire process of gathering the voluminous data that was required whilst descriptive research design enabled the researcher to provide explicit descriptions of the data statistics about FDI and fiscal policy in Libya in order to succinctly decipher the relationships between the two variables. This is due to the fact that the adopted case study research method was a useful strategy for conducting empirical inquiry for the facilitation of an investigation of the relationships between fiscal policy parameters and FDI in Libya as a contemporary phenomenon of the country's economy. The case study research design adopted in this study involved collection of quantitative data as an evidence to aid hypothesis testing and making of conclusions, and it also heavily relied on various references as sources of secondary data used as evidence. This secondary sources of data included relevant online databases such as the Central Bank of Libya Database, IMF, UNCTAD and World Bank Database, This was in addition to reviewing of other secondary sources of data such as books, reports, journal articles for additional information. The case study research design was an all-inclusive approach constituting the logic of study design, and techniques of data collection and analysis adopted in this study.

Considering that most of the data collected in this case study was descriptive in nature since it highlights various aspects, patterns or trends of FDI and fiscal policy variables in Libya; a descriptive research design became inevitable since only secondary data was collected thus requiring critical description and analysis in order to decipher any essential meaning in the observed patterns and trends so that relationships under investigations could be determined. The use of this research design was necessary to make sure descriptions and inferences were made concerning indicators of FDI in Libya as well as determining the extent of how FDI is influenced by fiscal policy in the country through observed directions and strength of relationships between FDI and fiscal policy. However, since quantitative data was collected

concerning FDI and fiscal policy indicators in Libya, the descriptions were also quantitative in nature. The quantitative secondary data collected in this case study was heavily relied on to provide descriptions of indicators the Libyan fiscal policy and FDI prior to subjecting the collected data to data analysis techniques for the determination of any significant relationships that exist. Furthermore, fiscal policy and FDI characteristics in Libya were also described through determination of their descriptive statistics such as averages and frequencies. Thus, combination of case study and descriptive research designs was crucial in order to facilitate collection as well as description of data concerning fiscal policy and FDI indicators in Libya to allow a succinct understanding FDI and fiscal policy in Libya as well as determining the significant relationships that exist between the two.

Furthermore, in order to decipher any meaningful trends or patterns among study variables or significant relationships between study variables descriptive analytical methods and quantitative statistical analysis techniques were used to facilitate data analysis. For instance, simple linear regression model was used in establishing the relationship between fiscal policy and FDI in Libya as well as determining the influence of former on latter through the assistance of SPSS software. The study period of this case study is duration of 11 years between 2000 and 2010, and it represents a period characterised by varied economic situations in Libya, especially the period preceding and following suspension of economic sanctions as well as restructuring of Libyan economy through liberalisation.

6.2 Theoretical Model

This case study adopted a simple linear regression theoretical model which aims to facilitate investigation of the relationship between the dependent variable (foreign direct investment) and the independent variables such as Country Risk (CR), Human Capital (HC), Gross Domestic Product (GDP), Corporate Income Tax Rate (CTR), Government Budget Surplus (GBS), and Government Expenses (GEX). In this model, there is a presumption that the dependent variable isin some way (to some extent/degree) dependent or it canbe systematically predicted or forecasted from the independent variables of the study, but the independent variables in this model are to some extentbelieved to influence dependent variable in an independent manner. In general, the goal of adopting simple linear regression model in this case study was to make sure that an explanation of differences in the study'sdependent variable values was achieved based on the data gathered concerning the independent variables in the study. Hence, the decision to adopt simple linear regression

model in this study was purely done since the case study primarily aimed to investigate the types of relationshipsthat exist between the dependent variable and the independent variables in the study as well as determining the direction and strength of the relationships between the independent variables and the dependent variable in the study through correlation coefficients (Blomström and Kokko,1998 ; Clark,2000; Dunning, 1993; Faeth,2009; Hartman,1985; Morisset and Pirnia,2001; Persson and Tabellini,2004).

The simple linear regression model that was adopted for this case study is an important tool for investigation of relationships between study variables, but it can only compare two variables at a time, hence at times it is regarded as bivariate regression because the existing relationship can only be investigated between two study variables at a time(Clark, 2000;Ragazzi, 1973). In the simple linear regression model adopted for this study and expressed by the equation shown below the Y has been used to represent the dependent variable while X has been used to represent theindependent variables.

The equation for simple linear regression model used to conduct data analysis in this study isrepresented by the equation shown below:

Simple Linear Regression: $Y_i = \beta_0 + \beta_1 X_i + \varepsilon_i$

Where; Y_i - Dependent Variable
X_i - Independent Variable
β_0 - *Y*-intercept
β_1 - Change in mean of *Y* when *X* increases by 1 (slope)
ε_i - Random error term

The simple linear regression equation shown above has various elements where some are constants while others are variables. Of significant interest is the Greek letter epsilon (ε_i) in the equation which represents the uncertainty involved inpredicting the dependent variable using the independent variables. Therefore, it is know as an error term, implying that it represents the extent to whichparticular values of y (sample mean value on the best-fit line) deviates from the true mean value of Y (the value either above or below the best-fit line) for specific x values (Persson and Tabellini,2004 ; Clark,2000 ; Blomström and Kokko,1998) .

However, the simple linear regression in its classical form it cannot be used investigate the existing relationships thereby necessitating substitution of the equation elements with actual

values of the case study data. Thus, substituting the data values for case study variables into the equation above, an econometric form of the equation is obtained as shown below. However, a combination of multiple variables in the same equations yields a polynomial regression equation as shown below seeking to investigate the relationship that exist between the dependent variable (FDI) and all the independent variables in the case study such as (CR, HC, GDP,CTR, GBS and GEX)

FDI $= f$ (CR, HC, GDP, CTR, GBS, GEX)

$FDI_i = \beta_0 + (\beta_1 * CR_i) + (\beta_2 * HC_i) + (\beta_3 * GDP_i) + (\beta_4 * CTR_i) + (\beta_5 * GBS_i) + (\beta_6 * GEX_i) + \varepsilon_i$

Where; FDI: Foreign Direct Investment

CR: Country Risk

HC: Human Capital

CTR: Corporate Income Tax Rate

GDP: Gross Domestic Product

   GBS   GovernmentBudget Surplus

GEX: Government Expenses

ε_i= Random error term.

β = Parameters (β_0 = parameter at the Y-intercept)

However, in this case study the variables are:

Independent variables are:

CR: Country Risk

   HC: Human Capital

CTR: Corporate Income Tax Rate

   GDP: Gross Domestic Product

GBS: Budget Surplus

   GEX: Government Expenses

Whereas the dependent variable is the FDI: Foreign Direct Investment. This means that the study will investigate how FDI is influenced by each of the independent variables by determining the relationships between each of the independent variable and the dependent variable.

However, a simple linear regression model adopted in this study means that the relationships between two variables can only can be investigated and determined at a time. This constitutes to the most effective method to test the study hypotheses that were stated prior to the beginning of the analysis of the data obtained from the study variables(Persson and Tabellini,2004).

Hence, in order to make sure that the hypotheses stated in this study are tested, the relationships between the dependent variable (foreign direct investment) with each of the independent variables must be individually investigated; hence this will necessitated that the polynomial regression equation to be broken down into respective simple linear regression equations for each pair of bivariate variables, that is, between the dependent variable and a single independent variable at a time in order to giveseveral pairs of simple linear regression equations as shown by the relationship equations that follows:

1. Country Risk

$$FDI_i = \beta_0 + \beta_1 * CR_i + \varepsilon_i$$

2. Human Capital

$$FDI_i = \beta_0 + \beta_2 * HC_i + \varepsilon_i$$

3. Corporate Income Tax Rate

$$FDI_i = \beta_0 + \beta_2 * CTR_i + \varepsilon_i$$

4. Market Size (GDP)

$$FDI_i = \beta_0 + \beta_3 * GDP_i + \varepsilon_i$$

5. Government Budget Surplus

$$FDI_i = \beta_0 + \beta_{4*}GBS_i + \varepsilon_i$$

6. Government Expenses

$$FDI_i = \beta_0 + \beta_{5*}GEX_i + \varepsilon_i$$

Furthermore, it is important to note that there two major types of government expenses such as Government Consumption (GC) and Government Investments (GI) and the case study requires the relationship between each of the government expenses and Foreign Direct Investment (FDI) to be investigated. This is aimed at determining which of the government expenses has significant impact on Foreign Direct Investment (FDI) in Libya. Hence determination of the relationships between each of the government expenses such as GC and GI with FDI will help to know which of the government expenses has more impact on FDI compared to the other. The relationships between GC and GI with FDI are expressed through the equations below:

7. Government Consumption

$$FDI_i = \beta_0 + \beta_{5*}GC_i + \varepsilon_i$$

8. Government Investment

$$FDI_i = \beta_0 + \beta_{5*}GI_i + \varepsilon_i$$

However, in order to ensure that simple linear regression model is appropriately used for the analysis of the data obtained from the study variables some assumptions are usually made. Unfortunately, in this model the properties for such assumptions can only be roughly tested. Therefore, when simple linear regression model is used to conduct data analysis in a study, the assumptions that should be made include:

1. Y is in a normal distributionfor any particular value of X, and the varianceof Y is usually the same for all X values that can bepossibly achieved. (Note: The parameters represented by X and Y are those of the population)

2. The relationship between values of Y and X is linear in nature, implying that a plot of the mean of Y parameter valuesagainst the mean of X parameter values gives afunction of X expressed in form of a straight line.

3. The error term or random disturbance term is a random variable whose mean iszero and a variance that is constant both in the sampleandin the population

4. There is statistical independence between thevalues of Y parameter with one another.

6.3 Hypotheses

H1: There is negative and significant relationship between Corporate Income Tax Rate (TR) and Foreign Direct Investment (FDI) in Libya. The higher the tax rate (measured by the corporate tax rate), the less attractive a host country is to the multinational firms as taxes cut directly into their profits. A negative effect is expected on the FDI. The higher the tax rate (measured by the corporate tax rate), the less attractive a host country is to the multinational firms as taxes cut directly into their profits.

H2: There is a negative and significant relationship between Country Risk (CR) and Foreign Direct Investment (FDI) in Libya. Country with high political, financial, and social risks (measured by Country Risk) tends to be unattractive to foreign investors. Conversely, a more stable country tends to attract more foreign investors than a country that is less stable. The more stable a country is, the safer it appears to capital investors. From the foregoing, country risk can be a positive sign when risk is low or negative sign when risk is high. Either effect is therefore expected on FDI depending on how investors view the host country. Every country in the world falls between the numbers 1 through 100. Number 1 indicates most risky and 100 least risky country. The closer a country is to 100, the less risky that country is considered.

H3: There is a positive and significant relationship between Human Capital (HC) and Foreign Direct Investment (FDI) in Libya. Foreign investors tend to seek out countries or regions with accumulation of Human Capital (workforce). The more educated and skilful the workforce the more attractive it is to investors. The positive effect is expected on FDI.

H4: There is a positive and significant relationship between Market Size (GDP) and Foreign Direct Investment (FDI) in Libya. The larger the market (as measured by a country's Gross Domestic Product), the greater the attraction to the MNCs that want to invest. A large market is created out of a population with high income and high purchasing power. This is where the size of the middle class is very important. The size of a nation's middle class can essentially indicate the size of the market in a host country. A large market size (GDP) is expected to have a positive effect on FDI.

H5: There is a positive and significant relationship between Government Budget Surplus (GBS) and Foreign Direct Investment (FDI) in Libya. Budget surplus tend to encourage foreign direct investment in a host country as consistent budget surplus tend to point to fiscal discipline. A positive effect is expected on FDI.

H6: There is asignificant relationship between Government Expenses (GEX) and Foreign Direct Investment (FDI) in Libya.

H7: There is a significant difference between the impact of government consumption and government investment on Foreign Direct Investment (FDI) in Libya.

6.4 Data Sources

In order to achieve the objectives of this study collection of the necessary data on various fiscal policy and FDI indicators in Libya was imminent. This is due to the fact that achieving the study objectives involved accurate testing of the study hypotheses which required collection of the appropriate data that is accurate, reliable, adequate and credible which was achieved by using credible reference materials. However, since the study was secondary in nature, it involved collection of both quantitative and secondary data for easy analysis through quantitative data analysis techniques to facilitate relationshipsbetweenstudy variables to be determined(Clark,2000; Persson and Tabellini,2004).Moreover, the data collected on various indicators of fiscal policy and FDI in Libya was purely secondary data implying it had been previously collected by other people for other uses and was obtainable from credible, valid and reliable sources.Compared to primary data, secondary data offer various benefits such asit is more economical becauseit iseasily and quickly retrievable from different sources thussaving time and money(Blomström and Kokko,1998). Additionally, use of secondary data allowed collection of voluminous data sufficient for effective data analysis

to appropriately determine the presence of significant patterns, trends or relationships between the study variables (Clark,2000).

Furthermore, the secondary data collected had to be evaluated in order to determine the credibility, validity and reliability of data and utilised sources. For example, in order to make sure that the collected data explicitly satisfied the above mentioned requirements, it was ensured that the data sources used were available for perusal in future; it was also ensured that data sources were not out-dated and provided data that fell within the case study period for relevancy and appropriateness; it was also ensured that data sources were dependable by making sure they provided accurate and sufficient data to enable credible data analysis, hypothesis testing and conclusions (Clark,2000; Persson and Tabellini,2004).

However, in order to ensure that the data collected in this case study was credible, reliable and valid through evaluation of the above mentioned aspects, various secondary data sources were identified for data retrieval concerningLibyan FDI and fiscal policy over the case study period which is between 2000 and 2010. The secondary sources of data that were identified and considered for inclusion as reliable references for this case study included relevant online databases such as the Central Bank of Libya Database, World Bank Database, International Monetary Fund, Balance of Payments and International Financial Statistics Databases, United Nations Conference on Trade and Development and OECD, among others. This was in addition to reviewing of other secondary sources of data such as books, reports, journal articles for additional information concerning various aspects of the case study.

6.5 Analysis Techniques

In order to effectively achieve the study objectives or appropriately test the study hypotheses, the necessary analytical techniques had to be adopted to allow deciphering of any significant relationships between study variables or meaningful trends and/or patterns among study variables. However, both descriptive analytical methods and quantitative statistical analysis techniques were used in facilitating data analysis where simple linear regression model was used to allow the relationships between fiscal policy and FDI in Libya to be established as well as determining the influence of fiscal policy on FDI. This was achieved through the assistance of SPSS software. The SPSS Software was of immense assistance in conducting the entire data analysis in this which was essential to facilitate the testing of study hypotheses and making of conclusions.

The SPSS Software has been used to conduct the data analysis where descriptive statistics, ANOVA analysis, correlations analysis, residual statistics, coefficients, regression statistics as well as a scatterplot and a histogram. Descriptive statistics in the data analysis have been used for describing the basic features of the data collected during this case study. Descriptive statistics shown in the data analysis provide simple summaries such as means and standard deviations about the study data collected concerning sample or study variables. Moreover, descriptive statistics together with simple graphics analysis provided in the data analysis such as scatterplots and histograms, form the basis of quantitative analysis of the data collected in this case study.This is mainly because histograms and scatterplots have been used in the analysis of data in this study as graphical representations to show a visual outlook of the study data distribution so that any significant relationships can be highlighted.Simple one-way ANOVA analyses were also conducted using SPSS Software with a purpose of checking whether significant differences existed between case study years' study variables, both independent and dependent.However, apart from the use of ANOVA analysis to determine differences between study variables, it is has also been used in this study to decipher trends, patterns or relationships that exist between study variables.

Furthermore, regression and correlation analysis in the data analysis of this study has been used to identify relationships between the dependent variable in this study (foreign direct investments) and independent variables (fiscal policy parameters). This involved hypothesizing of a relationship model, and actual data values of study variable parameters (both dependent and independent) were used to develop a regression equation which would be used to determine correlations between the study variables. However, since the simple linear regression model used was deemed satisfactory, the developed regression equation for each relationship considered can be used in predicting the value of the dependent variable (FDI) when the values for the independent variables (fiscal policy parameters) are given. Thus, the developed regression equation can be used to carryout correlational analysis between FDI and fiscal policy parameters when values for latter are provided. Moreover, residual statistics can be calculated from the differences between expected and actual values of the dependent variable and the independent variables where residual coefficients in a multipleregression model are obtained from an estimation of "least squares" aimed at mean

squared error minimization. However, in the hypothesized simple linear regression model for this study, and considering the used data for the study variables is in standardized form, these coefficients are represented by the Y-intercept of the regression line.

CHAPTER VII: STUDY RESULTS AND ANALYSIS OF STUDY DATA

7.1 Study Data

This section presents the study data retrieved from various sources of data used in this case study. The study data is mainly retrieved about the dependent variable (FDI) as well as independent variables (fiscal policy parameters) over a duration of eleven years between 2000 and 2010 which constitutes the case study time period.

Table 5: Overall data for the study variables

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
FDI in $ million	141	-133	145	143	357	1038	2038	3850	3180	3310	1909
FDI as % of GDP	0.37	-0.39	0.66	0.55	1.07	2.28	3.75	6.14	3.9	5.63	2.65
CR	45	45	50	50	55	55	55	55	60	60	55
HC in million	1.801	1.87	1.9436	2.00	2.06	2.12	2.18	2.25	2.30	2.35	2.37
GDP in $ billion	33.47	34.0	21.912	26.2	33.2	45.4	55.0	62.6	81.3	58.7	71.9
CT R %	30.8	30.8	30.8	30.8	30.8	30.8	40	40	40	40	20
GBS, % GDP	29.8	12.3	3.0	8.4	9.5	14.7	38.2	37.7	28.6	16.9	7.5
GEX as % of GDP	79.9	88.1	88.9	74.3	68.7	61.9	54.2	61.8	60.1	52.3	50.5
GC as, % of GDP	66.5	75.2	75.0	53.2	57.3	51.9	33.2	36.4	32.2		
GI as % of GDP	13.2	12.9	13.9	21.1	11.5	9.9	21	25.4	27.9		

Source: International Monetary Fund,2011 , World Bank, 2011 and United Nations Conference on Trade and Development, 2011

7.2 Relational data between Study Variables

This section presents relational data between study data concerning the dependent variable (FDI) and each of the specific independent variables considered in this case study. However, apart from presenting relational data between FDI and six parameters of fiscal policy there are two additional relational data obtained from subdivision of the government expenses into two types of government expenses such as government consumption and government investments in order to determine which between the has more influence on the country's FDI.

Table 6: The relationship between CTR and FDI

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
FDI $ millions	141	-133	145	143	357	1038	2038	3850	3180	3310	1909
CTR	30.8	30.8	30.8	30.8	30.8	30.8	40	40	40	40	20

Source: World Bank, 2011 and United Nations Conference on Trade and Development, 2011

Table 7: The relationship between CR and FDI

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
FDI in $ millions	141	-133	145	143	357	1038	2038	3850	3180	3310	1909
Country Risk (CR), %	45	45	50	50	55	55	55	55	60	60	55

Source: International Monetary Fund, 2011 and United Nations Conference on Trade and Development, 2011

Table 8: The relationship between HCand FDI

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
FDI in $ millions	141	-133	145	143	357	1038	2038	3850	3180	3310	1909
Human Capital (HC)	1801053.8	1872069.2	1943603.2	2005730.2	2067876.2	2127432.9	2189598.9	2253432.3	2306727.316	2352625.4	2379115.6

Source: World Bank, 2011 and United Nations Conference on Trade and Development, 2011

Table 9: The relationship between Market Size (GDP) and FDI

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
FDI in $ millions	141	-133	145	143	357	1038	2038	3850	3180	3310	1909
Market Size (GDP) in $ million	3847 0.51	3406 1.33	21912. 65	2623 5.92	3329 2.75	4545 1.48	5507 6.73	6266 8.04	8137 6.21	5876 1.95	7194 4.75

Source: United Nations Conference on Trade and Development, 2011

Table 10: The relationship between GBS and FDI

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
FDI, (%GDP)	0.37	-0.39	0.66	0.55	1.07	2.28	3.75	6.14	3.9	5.63	2.65
GBS,(% GDP)	29.8	12.3	3.0	8.4	9.5	14.7	38.2	37.7	28.6	16.9	7.5

Source: World Bank, 2011 and United Nations Conference on Trade and Development, 2011

Table 11: The relationship between GEX and FDI

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
FDI,(%GDP)	0.37	-0.39	0.66	0.55	1.07	2.28	3.75	6.14	3.9	5.63	2.65
GEX,(%GDP)	79.9	88.1	88.9	74.3	68.7	61.9	54.2	61.8	60.1	52.3	50.5

Source: World Bank, 2011 and United Nations Conference on Trade and Development, 2011

Table 12: Relationship between GCand FDI

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
(FDI), %GDP	0.37	-0.39	0.66	0.55	1.07	2.28	3.75	6.14	3.9	5.63	2.65
GC (, % GDP)	66.5	75.2	75.0	53.2	57.3	51.9	33.2	36.4	32.2		

Source: World Bank, 2011 and United Nations Conference on Trade and Development, 2011

Table 13: Relationship between GI and FDI

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
(FDI), %GDP	0.37	-0.39	0.66	0.55	1.07	2.28	3.75	6.14	3.9	5.63	2.65
GI, (% GDP)	13.2	12.9	13.9	21.1	11.5	9.9	21	25.4	27.9		

Source: World Bank, 2011 and United Nations Conference on Trade and Development, 2011

7.3 Analysis of the Study dataand discussionof the results

This section presents output of the analysis of study data through the assistance of SPSS Software. The data analysis is divided into eight subsections where first six subsections of the data analysis aim to determine the relationship between FDI and the six parameters of fiscal policy considered in this study. However, the sixth fiscal policy parameter (the government expenses) is further subdivided into two types of government expenses i.e. government consumption (GC) and government investments (GI) and data analysis is conducted to establish the strength of their relationships with FDI in order to determine which government expense between the two has more significant influence on FDI in Libya. This chapter also provides a discussion of the study data analyzed. A discussion is provided for each of the relationship established through data analysis between the dependent variable and the respective independent variables with the assistance of the SPSS Software. The discussion considers three major components of the data analysis in each relationship such as descriptive statistics, correlational analysis and regression analysis.

First Objective: To investigate the relationship between Corporate Income Tax Rate (CTR) and Foreign Direct Investment (FDI) in Libya.

Descriptive Statistics:

Table 14: Descriptive Statistics

	Mean	Std. Deviation	N
Net Foreign Direct Investment (FDI) in $million	108.527	1265.681847	11
Corporate Income Tax Rate	33.16	6.275	11

Source:Author processing, 2013

Correlation Analysis:

98

Table 15: Correlations

		Net Foreign Direct Investment (FDI) in $million	Corporate Income Tax Rate
Pearson Correlation	Net Foreign Direct Investment (FDI) in $million	1.000	.343
	Corporate Income Tax Rate	.343	1.000
Sig. (1-tailed)	Net Foreign Direct Investment (FDI) in $million	.	.151
	Corporate Income Tax Rate	.151	.
N	Net Foreign Direct Investment (FDI) in $million	11	11
	Corporate Income Tax Rate	11	11

Source: Author processing, 2013

Figure 8: Scatterplot
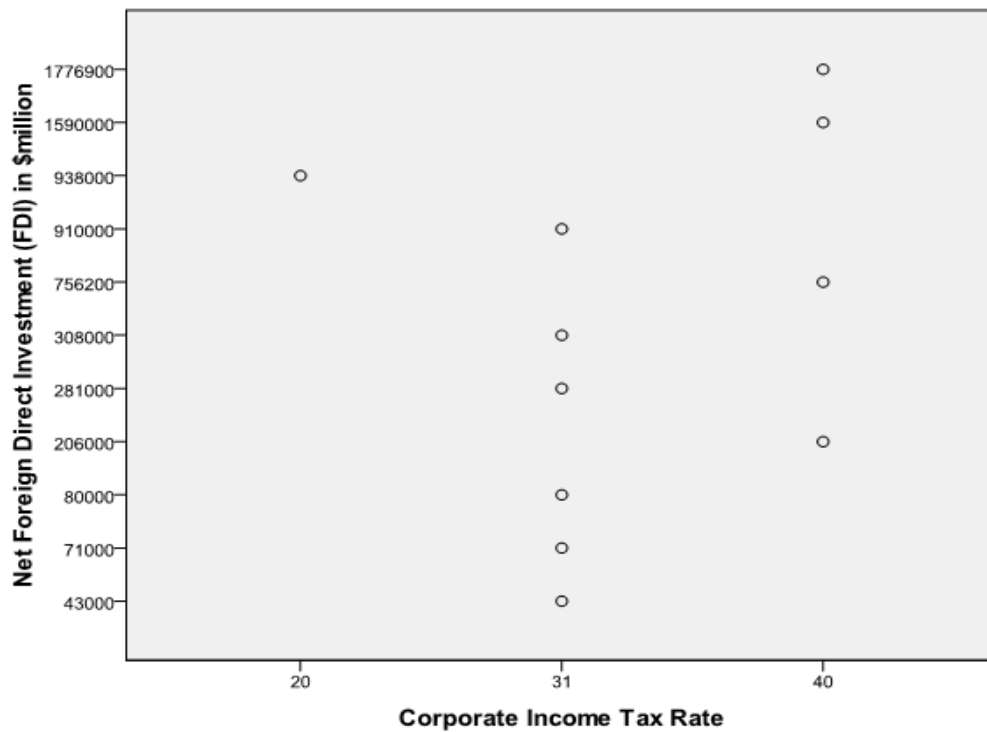
Source: World Bank, 2011 and United Nations Conference on Trade and Development, 2011

Regression Analysis:

Table 16: Variables Entered/Removedb

Model	Variables Entered	Variables Removed	Method
1	Corporate Income Tax Rate[a]	.	Enter

a. All requested variables entered.

b. Dependent Variable: Net Foreign Direct Investment (FDI) in $million

Source:Author processing, 2013

Table 17: Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.343[a]	.118	.020	609670.033

a. Predictors: (Constant), Corporate Income Tax Rate

b. Dependent Variable: Net Foreign Direct Investment (FDI) in $million

Source:Author processing, 2013

Table 18: ANOVAb

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	4.456E11	1	4.456E11	1.199	.302[a]
	Residual	3.345E12	9	3.717E11		
	Total	3.791E12	10			

a. Predictors: (Constant), Corporate Income Tax Rate

b. Dependent Variable: Net Foreign Direct Investment (FDI) in $million

Source:Author processing, 2013

Table 19: Coefficients[a]

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
1(Constant)	-482937	1035389.9		-.466	.652		
Corporate Income Tax Rate	33641.46	30724.65	.343	1.095	.302	1.000	1.000

Source: Author processing, 2013

Table 20: Residuals Statistics[a]

	Minimum	Maximum	Mean	Std. Deviation	N
Predicted Value	189892.33	862721.69	632736.36	211097.309	11
Residual	-656721.688	914178.313	.000	578383.778	11
Std. Predicted Value	-2.098	1.089	.000	1.000	11
Std. Residual	-1.077	1.499	.000	.949	11

a. Dependent Variable: Net Foreign Direct Investment (FDI) in $million
Source: Author processing, 2013

Figure 9: Histogram
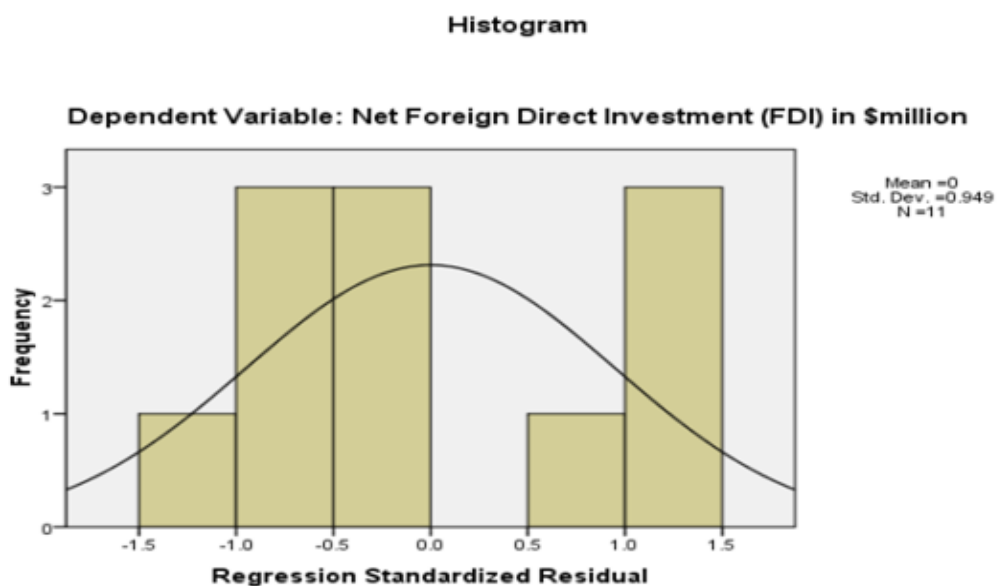
Histogram

Dependent Variable: Net Foreign Direct Investment (FDI) in $million

Mean =0
Std. Dev. =0.949
N =11

Normal P-P Plot of Regression Standardized Residual

Source: Author processing, 2013

Figure 10: Normal P-P Plot of Regression Standardized Residual

Normal P-P Plot of Regression Standardized Residual

Dependent Variable: Net Foreign Direct Investment (FDI) in $million
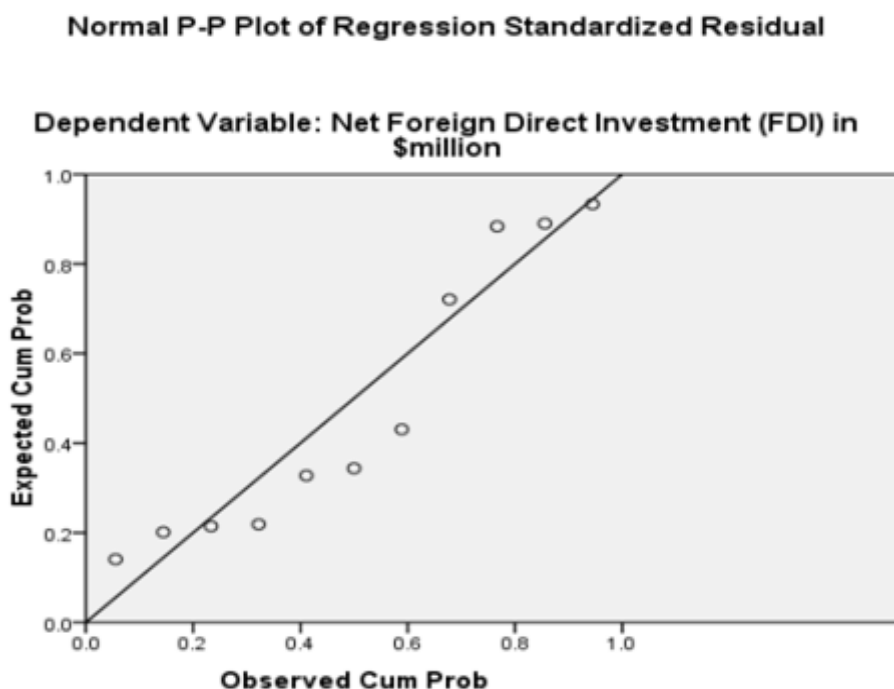
Source: Author processing, 2013

The goal of the first objective was to investigate the relationship between Corporate Income Tax Rate (CTR) and Foreign Direct Investment (FDI) in Libya.However, the descriptive statistics on this relationship indicate that there are 11 samples that represents the 11 years considered in the case study where each year has different results from others. However, the means and standard deviations for Corporate Income Tax Rate (CTR), as a % and Net Foreign Direct Investment (FDI) are 33.1636and 108.527 (means) 6.27491and 1265.682 (standard deviations) respectively.

However, a consideration of the scatterplot in correlation analysis shows that the relationship between Corporate Income Tax Rate (CTR) and Foreign Direct Investment (FDI) in Libya is positive but not significant at 5% level of significance as the P-value is bigger than 0.05. The same can be seen from scatter plot as well which shows a poor relationship between these two variables. From an economic perspective, the observed relationship can be explained from the fact that there has not been consistency in the rates of corporate income tax as the government embarked on economy liberalisation policies over the case study period.

Moreover, changes in Corporate Income Tax Rate (CTR) have been observed to show insignificant and poor relationship with FDI mainly because of other factors beyond fiscal policy such as poor economic policies, Gaddafi's dictatorial leadership, economic sanctions and the perception that Libya supported terrorism over the case study period.

However, regression analysis shows that the regression equation is:

FDI = -482937 +33641.467*CTR

This implies that the model is insignificant at 5% level because the P-value of ANOVA table is bigger than 0.05. The scale variable and the interceptor are also not significant at 5% level. If the TR is zero at some point then FDI will be -482937.000and if there is an increase in TR, then FDI will increase by 33641.467times. The observed results of both correlation and regression analyses rejects the initially stated hypothesis which had proposed that there is significant relationship between Corporate Income Tax Rate (CTR) and Foreign Direct Investment (FDI). The rejection of null hypothesis indicates that the observed relationship is contrary to the expected mainly because of factors beyond fiscal policy.

Second Objective: To investigates the relationship between Country Risk (CR) and Foreign Direct Investment (FDI) in Libya.

<u>**Descriptive Statistics:**</u>

Table 21: Descriptive Statistics

	Mean	Std. Deviation	N
Net Foreign Direct Investment (FDI) in $million	108.527	1265.681847	11
Country Risk (CR), %	53.18	5.135	11

Source:Author processing, 2013

Correlation Analysis:

Table 22: Correlations

		Net Foreign Direct Investment (FDI) in $million	Country Risk (CR), %
Pearson Correlation	Net Foreign Direct Investment (FDI) in $million	1.000	.546
	Country Risk (CR), %	.546	1.000
Sig. (1-tailed)	Net Foreign Direct Investment (FDI) in $million	.	.041
	Country Risk (CR), %	.041	.
N	Net Foreign Direct Investment (FDI) in $million	11	11
	Country Risk (CR), %	11	11

Source: Author processing, 2013

Figure 11: Scatterplot
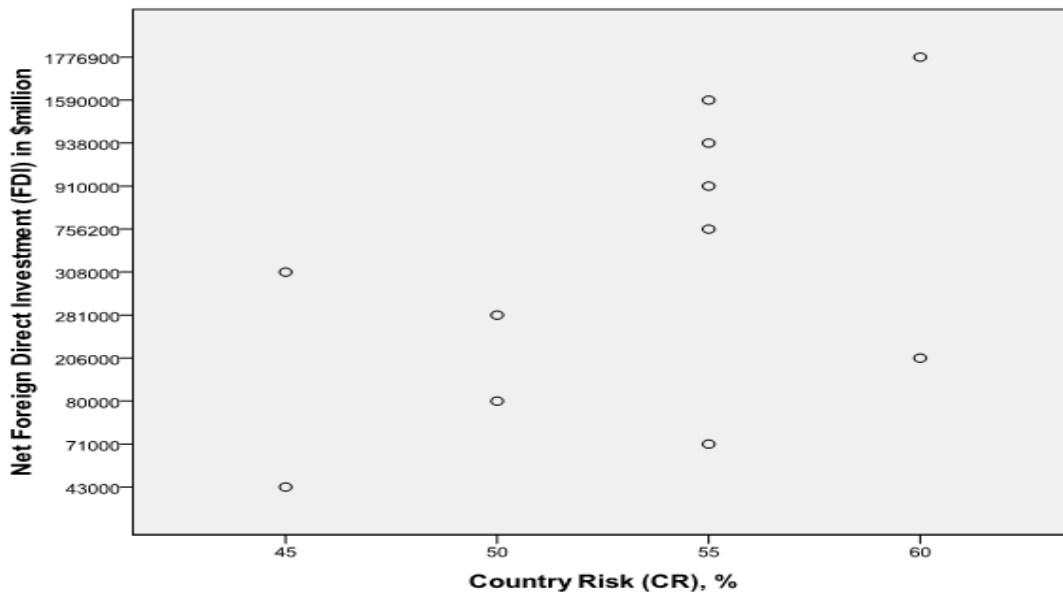
Source: Author processing, 2013

Regression Analysis:

Table 23: Variables Entered/Removedb

Variables Entered	Variables Removed	Method
Country Risk (CR), %[a]	.	Enter

a. All requested variables entered.

b. Dependent Variable: Net Foreign Direct Investment (FDI) in $million

Source: Author processing, 2013

Table 24: Model Summary

R	R Square	Adjusted R Square	Std. Error of the Estimate
.546[a]	.298	.220	543819.832

a. Predictors: (Constant), Country Risk (CR), %

Source: Author processing, 2013

Table 25: ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1.129E12	1	1.129E12	3.818	.082[a]
	Residual	2.662E12	9	2.957E11		
	Total	3.791E12	10			

a. Predictors: (Constant), Country Risk (CR), %

b. Dependent Variable: Net Foreign Direct Investment (FDI) in $million

Source: Author processing, 2013

Table 26: Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	-2847857.759	1788742.844		-1.592	.146		
	Country Risk (CR), %	65447.069	33492.872	.546	1.954	.082	1.000	1.000

a. Dependent Variable: Net Foreign Direct Investment (FDI) in $million

Source: Author processing, 2013

Figure 12: Dependent variable: Net Foreign Direct Investment (FDI) in $ million

Histogram

Dependent Variable: Net Foreign Direct Investment (FDI) in $million

Mean =-6.94E-16
Std. Dev. =0.949
N =11
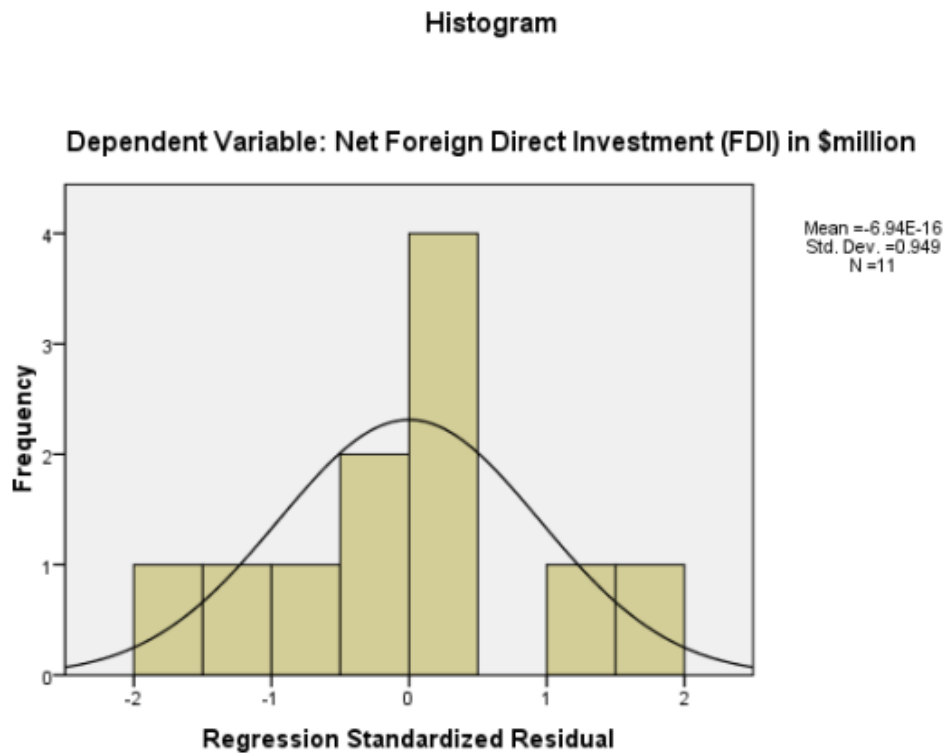
Source: Author processing, 2013

Figure 13: Normal P-P Plot of Regression Standardized Residual
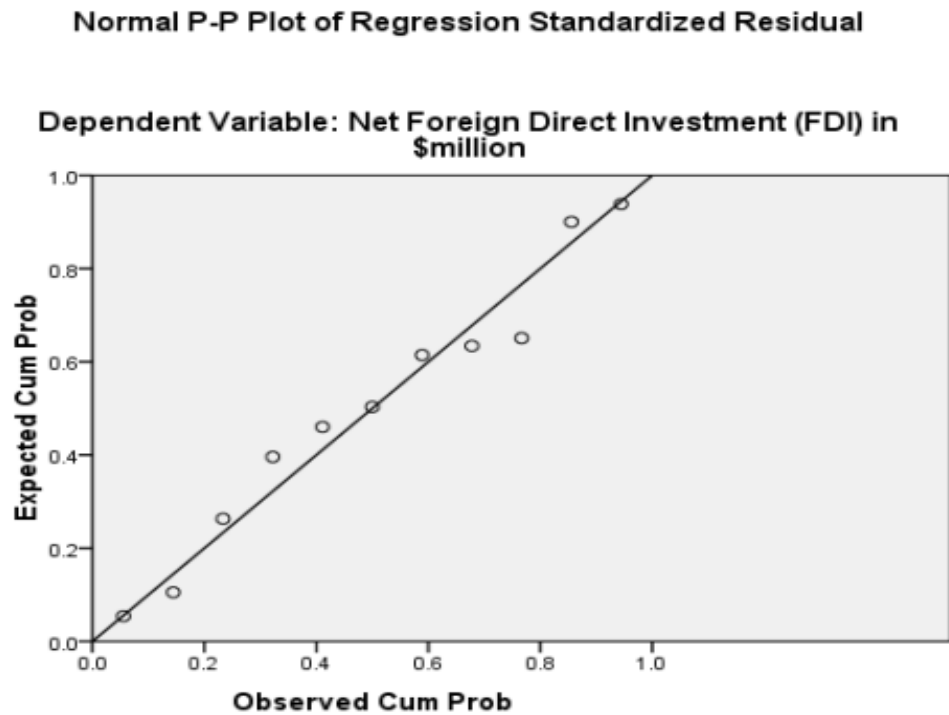
Source: Author processing, 2013

Table 27: Collinearity Diagnostics[a]

		Variance Proportions	
Eigenvalue	Condition Index	(Constant)	Country Risk (CR), %
1.996	1.000	.00	.00
.004	21.772	1.00	1.00

a. Dependent Variable: Net Foreign Direct Investment (FDI) in $million

Source: Author processing, 2013

The second objective aimed to investigate the relationship between Country Risk (CR) and Foreign Direct Investment (FDI) in Libya. The descriptive statistics on this relationship indicate that there are 11 samples representing the 11 years considered in the case study where each year has different results from others. However, the means and standard deviations for Country Risk (% CR) and Net Foreign Direct Investment (FDI) in $ million are

53.1818 and 108.527 (means) and 5.13455 and 1265.682 (standard deviations) respectively. However, correlation analysis indicates that there is significant correlation at the 0.01 level (2-tailed). Moreover, a scatterplot shows that the relationship between Country Risk (CR) and Foreign Direct Investment (FDI) in Libya is Negative and significant at 5% level of significance. It means if country risk (country stability, 1-100 ,1 indicates most risky and 100 least risky) is decrease the foreign direct investment will increasing. The same can be visually seen from scatter plot as well. From an economic perspective the relationship should be negative, However, regression analysis indicates that the regression equation is:

FDI = -2847857.759+65447.069*CR

This shows that the model is significant at 5% level because the P-value of ANOVA table is less than 0.05. Both the interceptor as well as the scale variable is significant at 5% level. This model explains the 54.6% of the variation in FDI. If the CR is zero at some point (high risk) then FDI will be -2847857.759and if there is an increase in CR(country stability 1-100), then FDI will increase by 65447.069times. The residuals are also normally distributed as shown by the histogram and normal p-p plot. This data analysis output confirms the hypothesis which proposed that there is a negative and a significant relationship between Country Risk (CR) and Foreign Direct Investment (FDI) in Libya.

Third Objective: To investigate the relationship between Human Capital (HC) and Foreign Direct Investment (FDI) in Libya.

Descriptive Statistics:

Table 28: Descriptive Statistics

	Mean	Std. Deviation	N
Net Foreign Direct Investment (FDI) in $million	108.527	1265.681847	11
Human Capital (HC)	2118115.00	197198.777	11

Source:Author processing, 2013

Table 29: Correlations

		Net Foreign Direct Investment (FDI) in $million	Human Capital (HC)
Pearson Correlation	Net Foreign Direct Investment (FDI) in $million	1.000	.578
	Human Capital (HC)	.578	1.000
Sig. (1-tailed)	Net Foreign Direct Investment (FDI) in $million	.	.031
	Human Capital (HC)	.031	.
N	Net Foreign Direct Investment (FDI) in $million	11	11
	Human Capital (HC)	11	11

Source: Author processing, 2013

Figure 14: Scatterplot
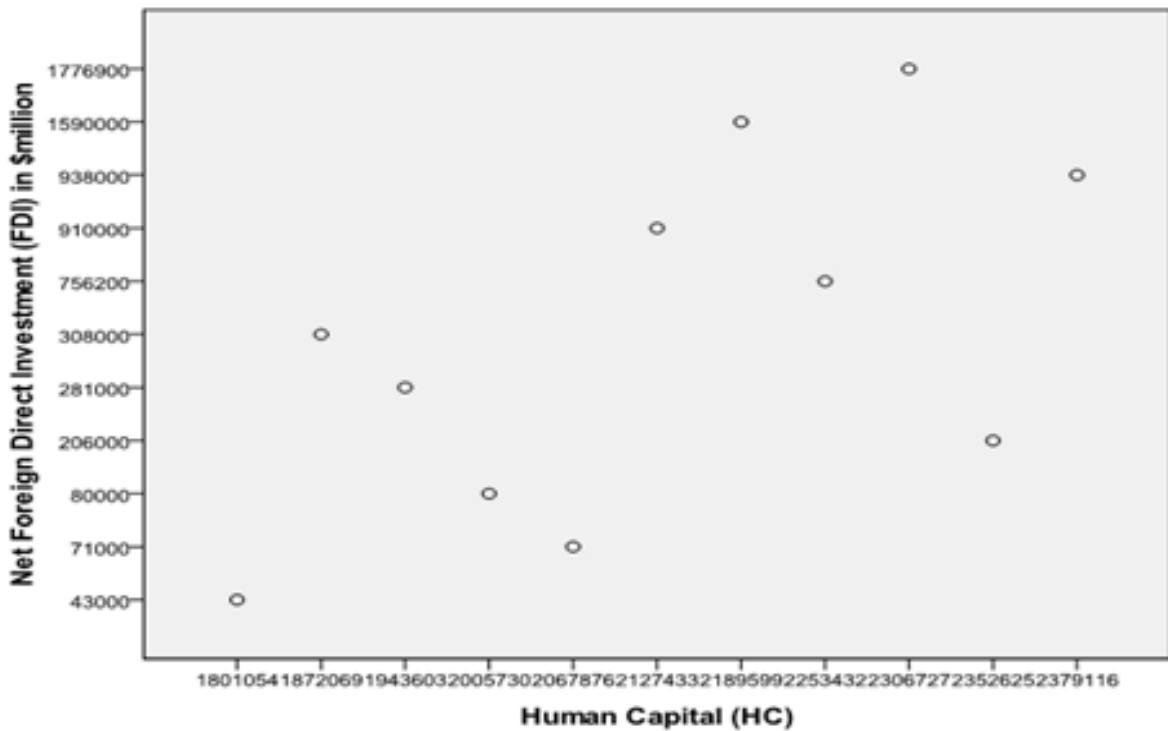
Source: Author processing, 2013

Regression Analysis:

Table 30: Variables Entered/Removed[b]

Model	Variables Entered	Variables Removed	Method
1	Human Capital (HC)[a]	.	Enter

a. All requested variables entered.

b. Dependent Variable: Net Foreign Direct Investment (FDI) in $million
Source: Author processing, 2013

Table 31: Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.578[a]	.334	.260	529635.412

a. Predictors: (Constant), Human Capital (HC)

b. Dependent Variable: Net Foreign Direct Investment (FDI) in $million
Source: Author processing, 2013

Table 32: ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1.266E12	1	1.266E12	4.514	.063[a]
	Residual	2.525E12	9	2.805E11		
	Total	3.791E12	10			

a. Predictors: (Constant), Human Capital (HC)

b. Dependent Variable: Net Foreign Direct Investment (FDI) in $million
Source: Author processing, 2013

Table 33: Coefficients[a]

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
1 (Constant)	-3189428.774	1806037.273		-1.766	.111		
Human Capital (HC)	1.805	.849	.578	2.125	.063	1.000	1.000

Dependent Variable: Net Foreign Direct Investment (FDI) in $million

Source:Author processing, 2013

Table 34: Residuals Statisticsa

	Minimum	Maximum	Mean	Std. Deviation	N
Predicted Value	60595.44	1103715.25	632736.36	355847.672	11
Residual	-849913.313	828270.063	.000	502456.270	11
Std. Predicted Value	-1.608	1.324	.000	1.000	11
Std. Residual	-1.605	1.564	.000	.949	11

a. Dependent Variable: Net Foreign Direct Investment (FDI) in $million

Source:Author processing, 2013

Figure 15: Histogram
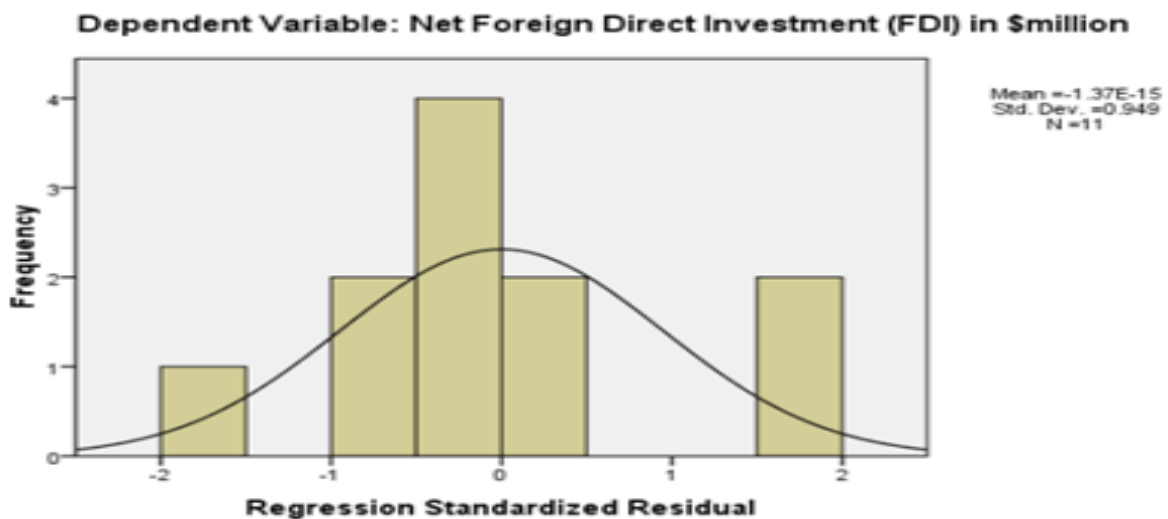
Source:Author processing, 2013

Figure 16: Normal P-P Plot of Regression Standardized Residual

Dependent Variable: Net Foreign Direct Investment (FDI) in $million
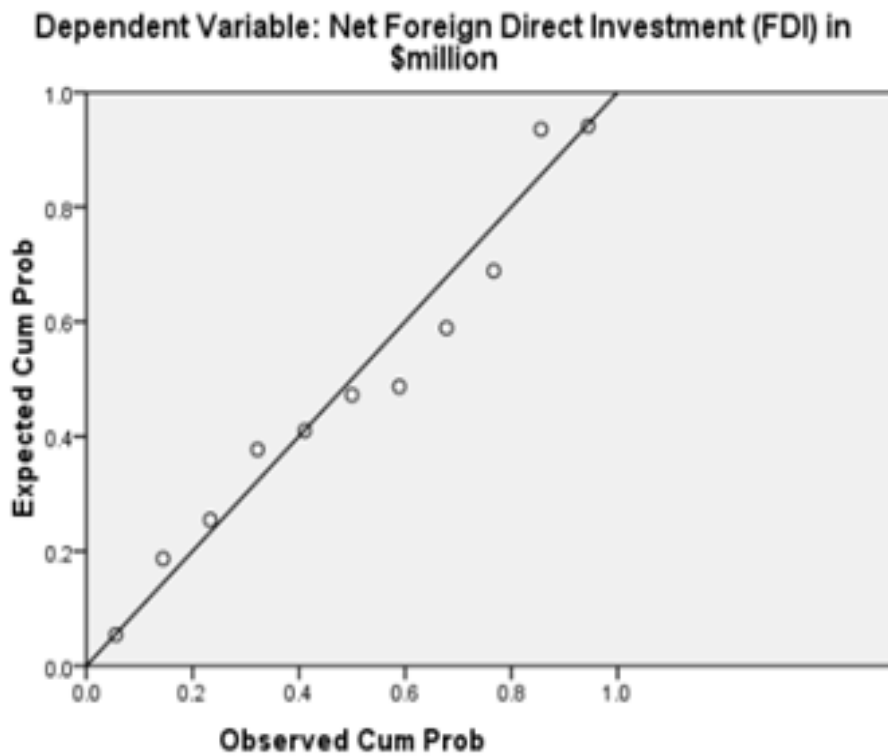
Source: Author processing, 2013

The third objective aimed to investigates the relationship between Human Capital (HC) and Foreign Direct Investment (FDI) in Libya. However, the descriptive statistics on this relationship indicate that there are 11 samples representing the 11 years considered in the case study where each year has different results from others. However, the means and standard deviations for Human Capital (HC) and Net Foreign Direct Investment (FDI) are 2118115.00 and 108.527 (means) and 197198.777 and 1265.682 (standard deviations) respectively.

However, correlation analysis indicates that there is a significant correlation at the 0.01 level (2-tailed). Moreover, a scatterplot shows that the relationship between Human Capital (HC) and Foreign Direct Investment (FDI) in Libya is positive and significant at 5% level of significance. It means if human capital is increasing the foreign direct investment is also increasing and vice-versa. This relationship can also be visually seen from scatter plot as

well. From an economic perspective, this implies that increasing human capital has been attracting more FDI, preferably due to availability of labour. This relationship between Human Capital (HC) and Foreign Direct Investment (FDI) in Libya was envisaged.

However, regression analysis shows that the regression equation is:

FDI = -3189428.774+1.805*HC

This implies that the model is significant at 5% level because the P-value of ANOVA table is less than 0.05. Both the interceptor as well as the scale variable is significant at 5% level. This model explains the75% of the variation in FDI. If the HC is zero at some point then FDI will be -3189428.774and if there is an increase HC, then FDI will increase by 1.805times. The residuals are also normally distributed as shown by the histogram and normal p-p plot. The relationships observed in both correlation and regression analyses collaboratively confirm the stated hypothesis which proposed that there is significant relationship between Human Capital (HC) and Foreign Direct Investment (FDI) in Libya.

Fourth Objective: To investigate the relationship between Market Size (GDP) and Foreign Direct Investment (FDI) in Libya.

<u>**Descriptive Statistics:**</u>

Table 35: Descriptive Statistics

	Mean	Std. Deviation	N
Net Foreign Direct Investment (FDI) in $million	108.527	1265.681847	11
Market Size (GDP in $ million)	48113.85	19314.12	11

Source:Author processing, 2013

Table 36: Correlations

		Net Foreign Direct Investment (FDI) in $million	Market Size (GDP in $ million)
Pearson Correlation	Net Foreign Direct Investment (FDI) in $million	1.000	.743
	Market Size (GDP in $ million)	.743	1.000
Sig. (1-tailed)	Net Foreign Direct Investment (FDI) in $million	.	.004
	Market Size (GDP in $ million)	.004	.
N	Net Foreign Direct Investment (FDI) in $million	11	11
	Market Size (GDP in $ million)	11	11

Source: Author processing, 2013

Figure 17: Scatterplot
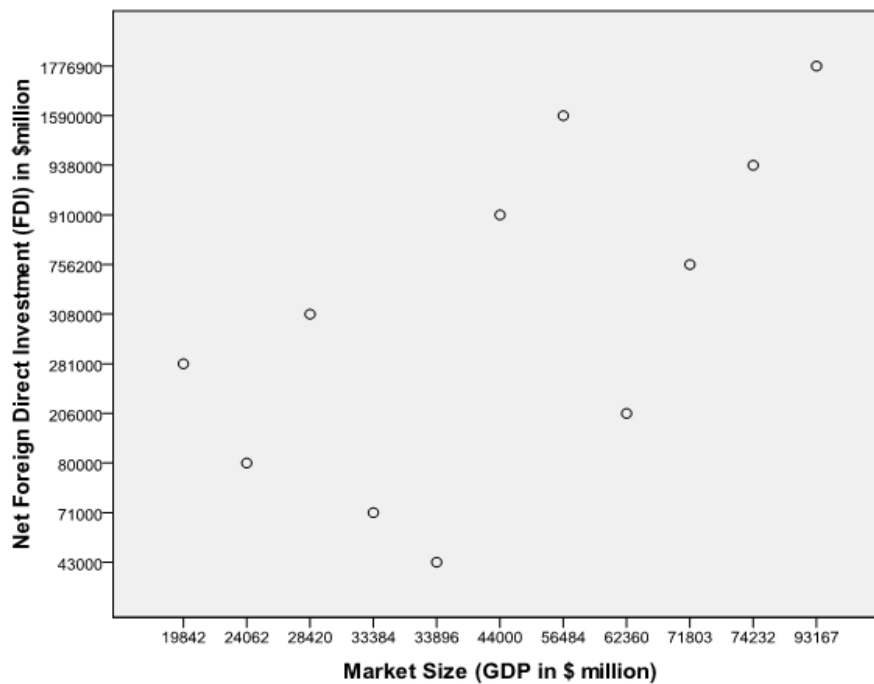
Source: Author processing, 2013

Regression Analysis:

Table 37: Variables Entered/Removedb

Model	Variables Entered	Variables Removed	Method
1	Market Size (GDP in $ million)[a]	.	Enter

a. All requested variables entered.

b. Dependent Variable: Net Foreign Direct Investment (FDI) in $million

Source:Author processing, 2013

Table 38: Model Summaryb

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.743[a]	.552	.502	434429.979

a. Predictors: (Constant), Market Size (GDP in $ million)

b. Dependent Variable: Net Foreign Direct Investment (FDI) in $million

Source:Author processing, 2013

Table 39: ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	2.092E12	1	2.092E12	11.086	.009[a]
	Residual	1.699E12	9	1.887E11		
	Total	3.791E12	10			

a. Predictors: (Constant), Market Size (GDP in $ million)

b. Dependent Variable: Net Foreign Direct Investment (FDI) in $million

Source:Author processing, 2013

Table 40: Coefficients^a

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
1 (Constant)	-307893.924	311392.401		-.989	.349		
Market Size (GDP in $ million)	19.103	5.737	.743	3.330	.009	1.000	1.000

Dependent Variable: Net Foreign Direct Investment (FDI) in $million

Source:Author processing, 2013

Table 41: Residuals Statistics^a

	Minimum	Maximum	Mean	Std. Deviation	N
Predicted Value	71140.23	1471839.75	632736.36	457420.378	11
Residual	-677345.375	818901.625	.000	412136.465	11
Std. Predicted Value	-1.228	1.834	.000	1.000	11
Std. Residual	-1.559	1.885	.000	.949	11

a. Dependent Variable: Net Foreign Direct Investment (FDI) in $million

Source:Author processing, 2013

Figure 18: Histogram

Dependent Variable: Net Foreign Direct Investment (FDI) in $million

Mean =-8.33E-17
Std. Dev. =0.949
N =11
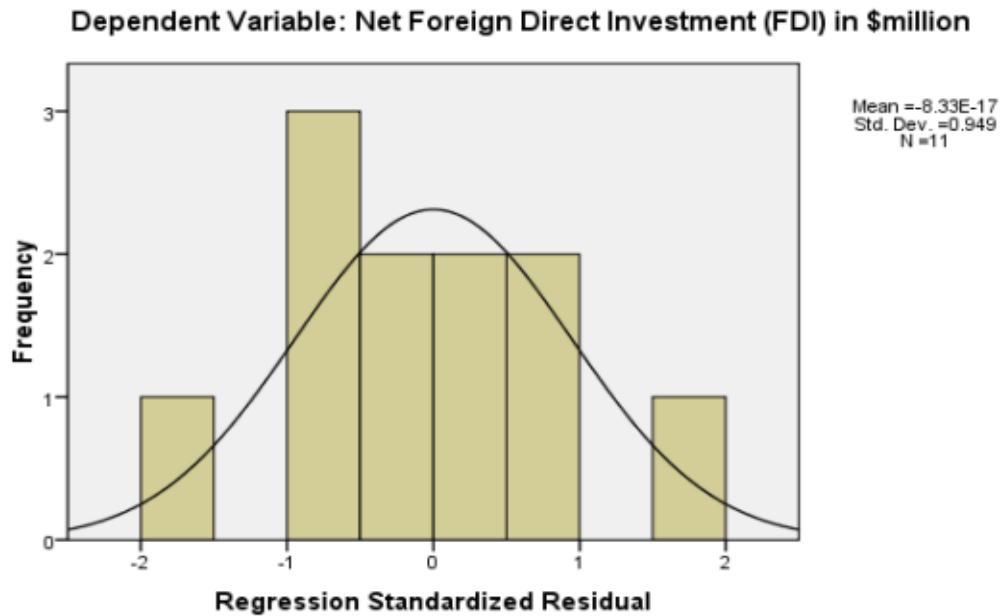
Source: Author processing, 2013

Figure 19: Normal P-P Plot of Regression Standardized Residual

Dependent Variable: Net Foreign Direct Investment (FDI) in $million

n $million

Mean =-8.33E-17
Std. Dev. =0.949
N =11

Source: Author processing, 2013

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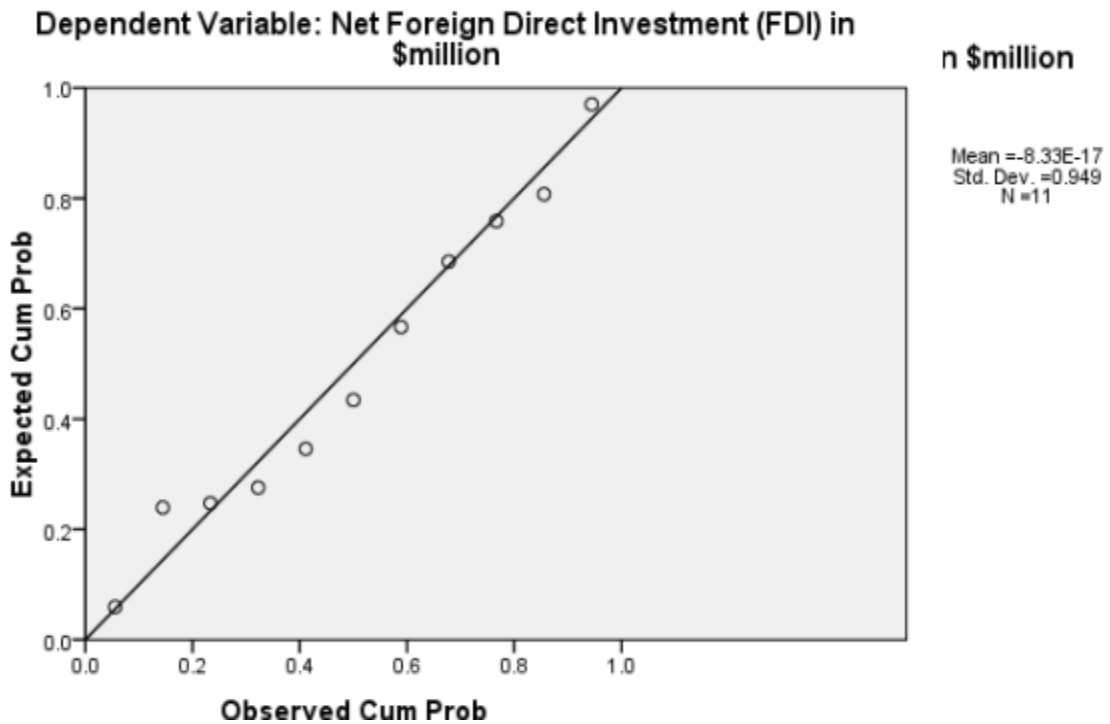
The fourth objective aimed to investigate the relationship between Market Size (GDP) and Foreign Direct Investment (FDI) in Libya.However, the descriptive statistics on this relationship indicate that there are 11 samples that represents the 11 years considered in the case study where each year has different results from others. However, the means and standard deviations for Market Size (GDP), GDP in $ million and Net Foreign Direct Investment (FDI are 48113.85and 108.527 (means) and 19314.12and 1265.682 (standard deviations) respectively.

However, correlation analysis shows that there is significant correlation between the two variables at the 0.01 level (2-tailed). Furthermore, a consideration of the scatterplot indicates that the relationship between Market Size (GDP) and Foreign Direct Investment (FDI) in Libya is positive and significant at 5% level of significance. It means if market size is increasing the foreign direct investment is also increasing and vice-versa. The scatterplot also show this relationship. From an economic point of view, this relationship was expected because high GDP are indicative of high levels of production mainly because favourable investment climate for both domestic and foreign investors, a situation which might attract significant levels of FDI.

The regression equation shown below was observed after regression analysis:

FDI = -307893.924+19.103*GDP

This indicates that the model is significant at 5% level because the P-value of ANOVA table is less than 0.05. The scale variable is significant at 5% level but interceptor is not significant for this model. The model explains the79.9% of the variation in FDI. If the GDP is zero at some point then FDI will be -307893.924and if there is an increase in GDP, then FDI will increase by 19.103times. The residuals are also normally distributed as shown by the histogram and normal p-p plot. The observed data analysis results in both correlation and regression analyses confirm the stated hypothesis that there is significant relationship Between Market Size (GDP) and Foreign Direct Investment (FDI) in Libya.

Fifth Objective: To investigate the relationship between Government Budget Surplus (GBS) and   Foreign Direct Investment (FDI) in Libya.

Descriptive Statistics:

Table 42: Descriptive Statistics

	Mean	Std. Deviation	N
Net Foreign Direct Investment (FDI), %GDP	0.4485999	1.96069	11
Government Budget Surplus (BS), % GDP	18.7818	12.59070	11

Source:Author processing, 2013

Correlation Analysis:

Table 43: Correlations

		Net Foreign Direct Investment (FDI), %GDP	Government Budget Surplus (BS), % GDP
Net Foreign Direct Investment (FDI), %GDP	Pearson Correlation	1	.507
	Sig. (2-tailed)		.111
	N	11	11
Government Budget Surplus (BS), % GDP	Pearson Correlation	.507	1
	Sig. (2-tailed)	.111	
	N	11	11

Source:Author processing, 2013

Figure 20: Scatterplot
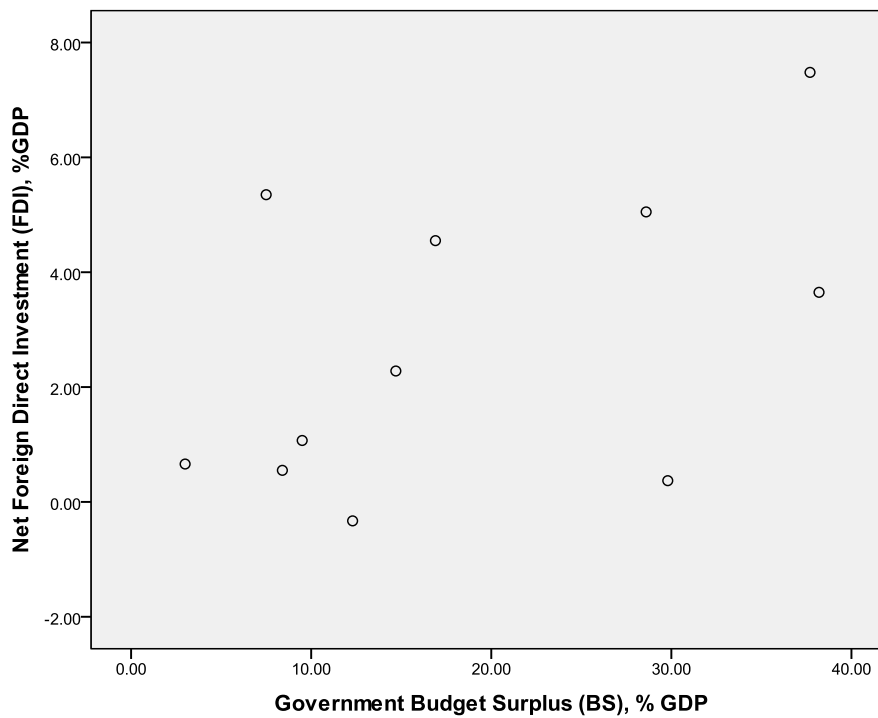
Source:Author processing, 2013

Regression Analysis:

Table 44: Variables Entered/Removed[b]

Model	Variables Entered	Variables Removed	Method
dimension0 1	Government Budget Surplus (BS), % GDP[a]	.	Enter

a. All requested variables entered.

b. Dependent Variable: Net Foreign Direct Investment (FDI), %GDP

Source:Author processing, 2013

Table 45: Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
dimension0 1	.507[a]	.257	.175	2.33126

a. Predictors: (Constant), Government Budget Surplus (BS), % GDP

b. Dependent Variable: Net Foreign Direct Investment (FDI), %GDP

Source:Author processing, 2013

Table 46: ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	16.945	1	16.945	3.118	.111[a]
	Residual	48.913	9	5.435		
	Total	65.858	10			

a. Predictors: (Constant), Government Budget Surplus (BS), % GDP

b. Dependent Variable: Net Foreign Direct Investment (FDI), %GDP

Source:Author processing, 2013

Table 47: Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.847	1.305		.649	.532
	Government Budget Surplus (BS), % GDP	.103	.059	.507	1.766	.111

a.   Dependent Variable: Net Foreign Direct Investment (FDI), %GDP

Source:Author processing, 2013

Table 48: Residual Statistics

	Minimum	Maximum	Mean	Std. Deviation	N
Predicted Value	1.1574	4.7967	2.7891	1.30174	11
Residual	-3.55825	3.72732	.00000	2.21163	11
Std. Predicted Value	-1.253	1.542	.000	1.000	11
Std. Residual	-1.526	1.599	.000	.949	11

a. Dependent Variable: Net Foreign Direct Investment (FDI), %GDP

Source:Author processing, 2013

Figure 21: Histogram

Histogram

Dependent Variable: Net Foreign Direct Investment (FDI), % GDP

Mean = -2.50E-16
Std. Dev. = 0.949
N = 11
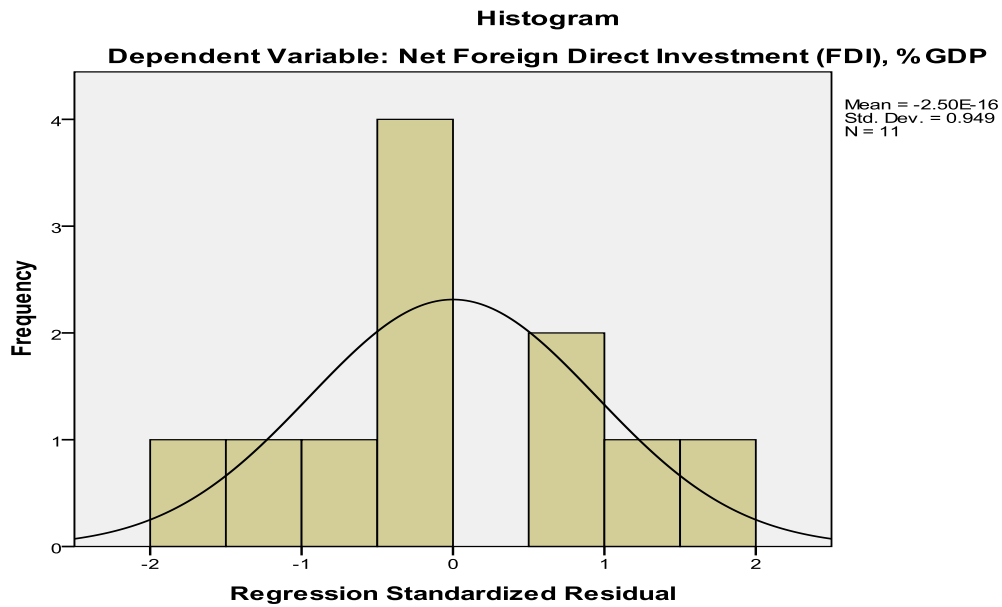
Source: Author processing, 2013

Figure 22: Normal P-P Plot of Regression Standardized Residual

Normal P-P Plot of Regression Standardized Residual

Dependent Variable: Net Foreign Direct Investment (FDI), % GDP
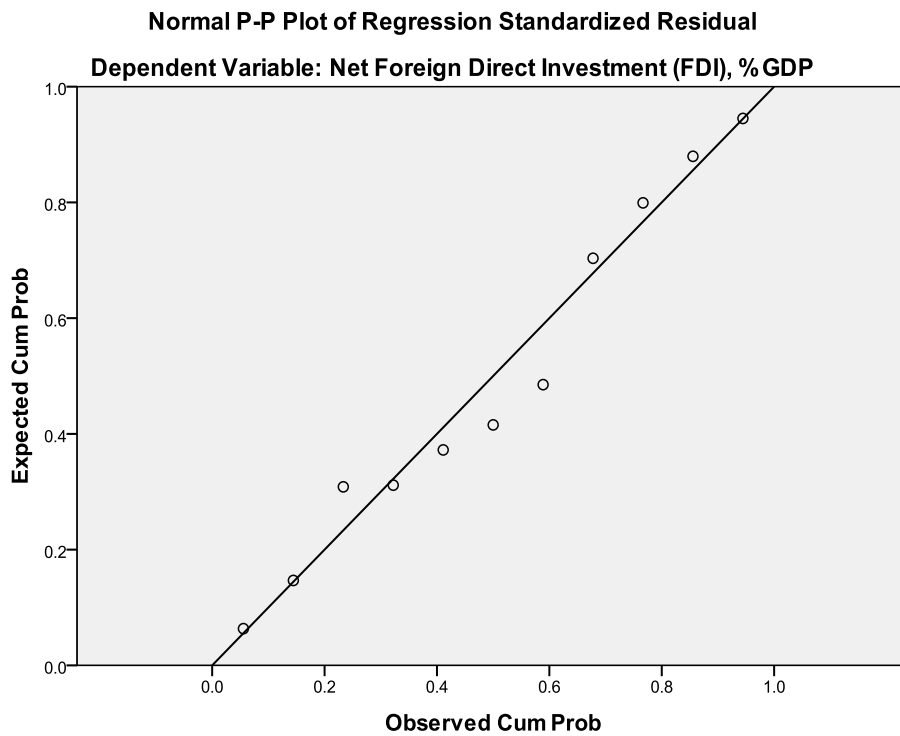
Source: Author processing, 2013

The goal of the fifth objective was to investigate the relationship between Government Budget Surplus (GBS) and Foreign Direct Investment (FDI) in Libya.However, the descriptive statistics on this relationship indicate that there are 11 samples that represents the 11 years considered in the case study where each year has different results from others. However, the means and standard deviations for Government Budget Surplus (BS), as % of GDP and Net Foreign Direct Investment (FDI), as a % of GDP are 18.7818and 0.4486 (means) and 12.59070and 1.96069 (standard deviations) respectively.

A consideration of the scatterplot in the correlation analysis shows that the relationship between Government Budget Surplus (GBS) and Foreign Direct Investment (FDI) in Libya is positive but not significant at 5% level of significance as the P-value is bigger than 0.05. The same can be seen from scatter plot as well which shows a poor relationship between these two variables. From an economic perspective, the positive relationship between Government Budget Surplus (GBS) and Foreign Direct Investment (FDI) in Libya is attributable to the fact that the government is able to offer fiscal incentives or finance other economic interventions aimed at promoting FDI.

However, regression analysis results to the regression equation shown below:

FDI = 0.847 +0.103*GBS

The above equation shows that the model is not significant at 5% level because the P-value of ANOVA table is bigger than 0.05. The scale variable and the interceptor are also not significant at 5% level. If the BS is zero at some point then FDI will be 0.847 and if there is an increase in one unit or BS, then FDI will increase by 0.103 times. The stated hypothesis which proposed that there was significant relationship between Government Budget Surplus (GBS) and Foreign Direct Investment (FDI) in Libya is rejected because despite the existed of a positive relationship between the two variables, the relationship is not significant to allow acceptance of the null hypothesis.

Sixth Objective: To investigate the relationship between Government Expenses (GEX) and Foreign Direct Investment (FDI) in Libya.

Descriptive Statistics:

Table 49: Descriptive Statistics

	Mean	Std. Deviation	N
Net Foreign Direct Investment (FDI), %GDP	0.4485999	2.56629	11
Government Expenses (GEX),%GDP	67.3364	13.78044	11

Source:Author processing, 2013

Correlation Analysis:

Table 50: Correlations

		Net Foreign Direct Investment (FDI), %GDP	Government Expenses (GEX),%GDP
Net Foreign Direct Investment (FDI), %GDP	Pearson Correlation	1	-.790**
	Sig. (2-tailed)		.004
	N	11	11
Government Expenses (GEX),%GDP	Pearson Correlation	-.790**	1
	Sig. (2-tailed)	.004	
	N	11	11

**. Correlation is significant at the 0.01 level (2-tailed).

Source:Author processing, 2013

Figure 23: Scatterplot
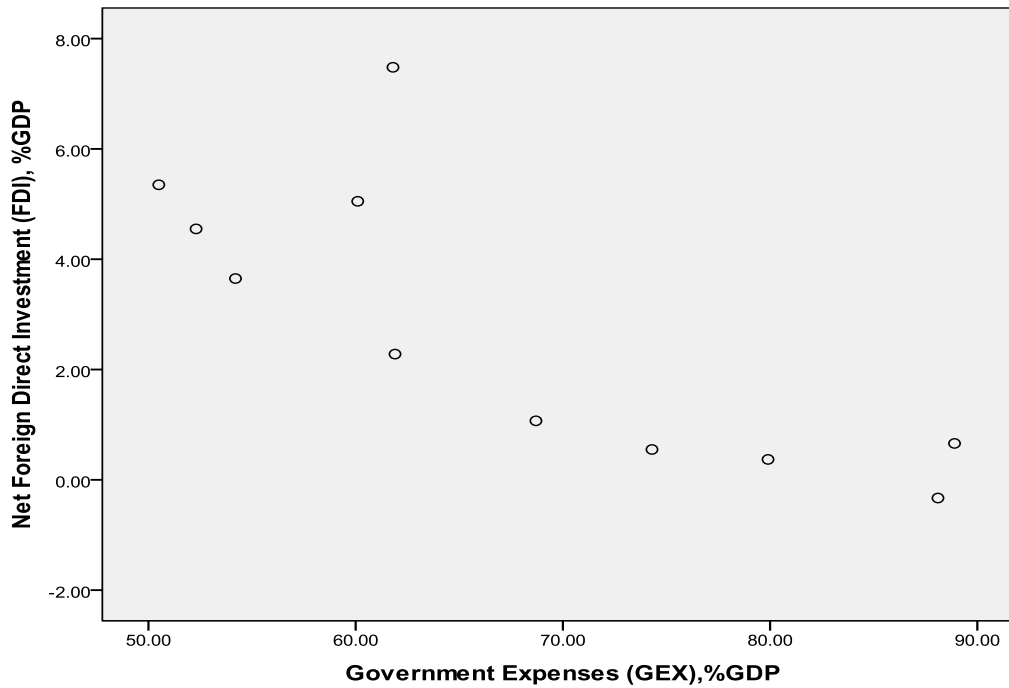
Source:Author processing, 2013

Regression Analysis:

Table 51: Variables Entered/Removed[b]

Model	Variables Entered	Variables Removed	Method
dimension0 1	Government Expenses (GEX),%GDP[a]	.	Enter

a. All requested variables entered.

b. Dependent Variable: Net Foreign Direct Investment (FDI), %GDP

Source:Author processing, 2013

Table 52: Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
dimension0 1	.790[a]	.625	.583	1.65762

a. Predictors: (Constant), Government Expenses (GEX),%GDP

b. Dependent Variable: Net Foreign Direct Investment (FDI), %GDP

Source:Author processing, 2013

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Table 53: ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	41.129	1	41.129	14.968	.004[a]
	Residual	24.729	9	2.748		
	Total	65.858	10			

a. Predictors: (Constant), Government Expenses (GEX),%GDP

b. Dependent Variable: Net Foreign Direct Investment (FDI), %GDP

Source:Author processing, 2013

Table 54: Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	12.699	2.610		4.866	.001
	Government Expenses (GEX),%GDP	-.147	.038	-.790	-3.869	.004

a. Dependent Variable: Net Foreign Direct Investment (FDI), %GDP

Source:Author processing, 2013

Table 55: Residuals Statistics[a]

	Minimum	Maximum	Mean	Std. Deviation	N
Predicted Value	-.3844	5.2668	2.7891	2.02802	11
Residual	-1.51841	3.87614	.00000	1.57256	11
Std. Predicted Value	-1.565	1.222	.000	1.000	11
Std. Residual	-.916	2.338	.000	.949	11

a.   Dependent Variable: Net Foreign Direct Investment (FDI), %GDP

Source:Author processing, 2013

Figure 24: Histogram

Histogram
Dependent Variable: Net Foreign Direct Investment (FDI), % GDP
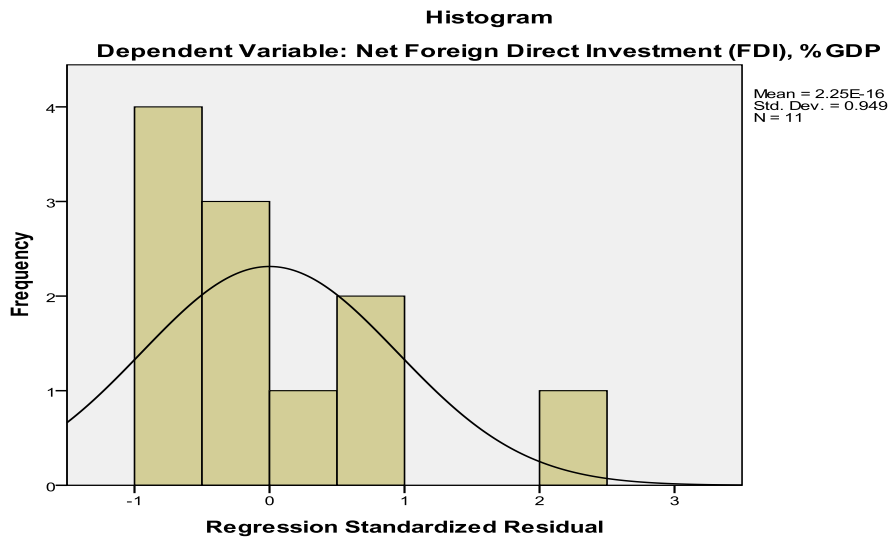
Source: Author processing, 2013

Figure 25: Normal P-P Plot of Regression Standardized Residual

Normal P-P Plot of Regression Standardized Residual
Dependent Variable: Net Foreign Direct Investment (FDI), % GDP
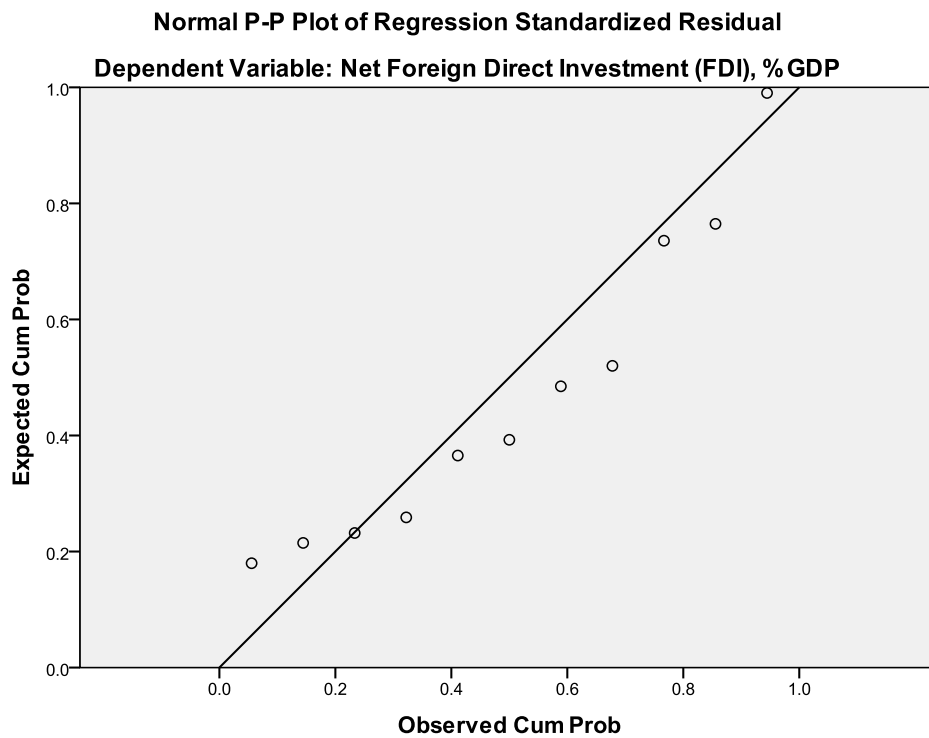
Source: Author processing, 2013

The sixth objective aimed to investigate the relationship between Government Expenses (GEX) and Foreign Direct Investment (FDI) in Libya.However, the descriptive statistics on this relationship indicate that there are 11 samples that represents the 11 years considered in the case study where each year has different results from others. However, the means and standard deviations for Government Expenses (GEX), as a % of GDP and Net Foreign Direct Investment (FDI), as a % of GDP are 67.3364and 0.4486 (means) and 13.78044and 1.96069 (standard deviations) respectively.

However, correlational analysis shows that there is significant correlation between Government Expenses (GEX) and Foreign Direct Investment (FDI)at the 0.01 level (2-tailed). Moreover, considering the scatterplot in the correlation analysis it can be observed that the relationship between Government Expenses (GEX) and Foreign Direct Investment (FDI) in Libya is negative and significant at 5% level of significance. It means if Government Expenses are increasing the foreign direct investment is decreasing and vice-versa. The same can be seen from scatter plot as well. From an economic perspective, this was expected because when the government increases its expenses especially the government consumption instead of government investments as observed in this case, the government must look for ways to raise the needed finances mostly through taxation which scares foreign investors hence the negative relationship observed is justifiable.

In the regression analysis the observed regression equation is:

FDI = 12.699-0.147*GEX

Therefore, this implies that the model is significant at 5% level because the P-value of ANOVA table is less than 0.05. Both the interceptor as well as the scale variable is significant at 5% level. This model explains the 62.5% of the variation in FDI. If the GEX is zero at some point then FDI will be 12.699 and if there is an increase in GEX, then FDI will decrease by 0.147 times. The residuals are also normally distributed as shown by the histogram and normal p-p plot. The observed relationship between Government Expenses (GEX) and Foreign Direct Investment (FDI) as a result of both correlation and regression analyses confirms the initially stated hypothesis which has proposed that there was significant relationship between GEX and FDI. However, the relationship is negative as it was expected to be since government constitutes the highest percentage of government expenses compared to government investments that would increase FDI.

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Relationship between government consumption (GC) and FDI

Descriptive Statistics:

Table 56: Descriptive Statistics

	Mean	Std. Deviation	N
Net Foreign Direct Investment (FDI), %GDP	0.4485999	1.96069	9
Government Consumption (GC), % GDP	53.4333	16.87224	9

Source:Author processing, 2013

Correlation Analysis:

Table 57: Correlations

		Net Foreign Direct Investment (FDI), %GDP	Government Consumption (GC), % GDP
Net Foreign Direct Investment (FDI), %GDP	Pearson Correlation	1	-.843[**]
	Sig. (2-tailed)		.004
	N	9	9
Government Consumption (GC), % GDP	Pearson Correlation	-.843[**]	1
	Sig. (2-tailed)	.004	
	N	9	9

**. Correlation is significant at the 0.01 level (2-tailed).

Source:Author processing, 2013

Figure 26: Scatterplot
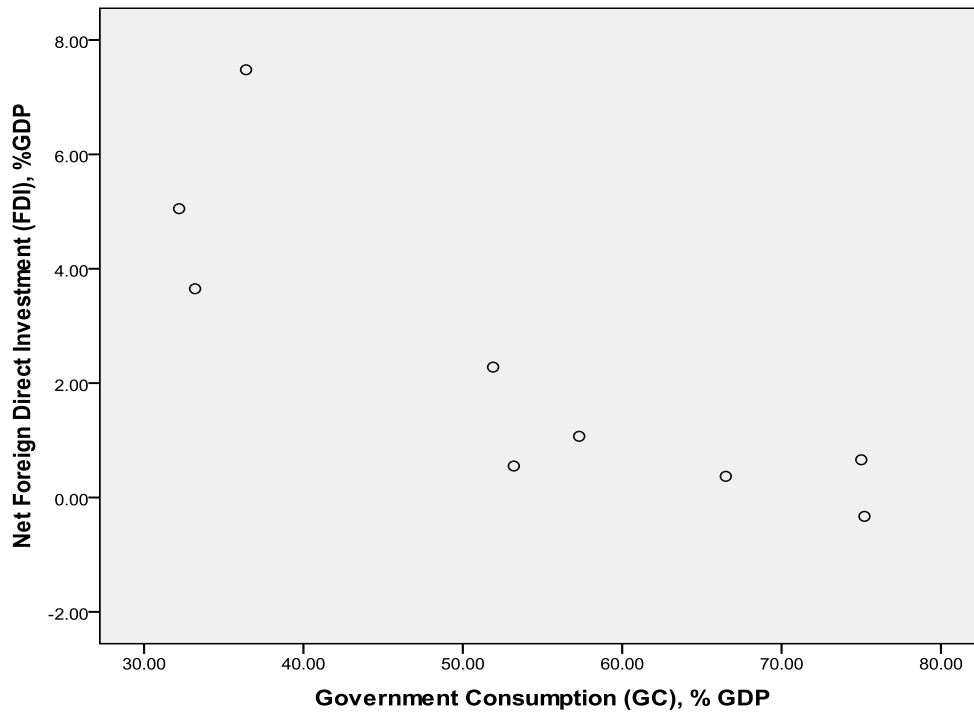
Source: Author processing, 2013

Regression Analysis:

Table 58: Variables Entered/Removed[b]

Model	Variables Entered	Variables Removed	Method
dimension0 1	Government Consumption (GC), % GDP[a]	.	Enter

a. All requested variables entered.

b. Dependent Variable: Net Foreign Direct Investment (FDI), %GDP

Source: Author processing, 2013

Table 59: Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
dimension0 1	.843[a]	.711	.670	1.49418

a. Predictors: (Constant), Government Consumption (GC), % GDP

b. Dependent Variable: Net Foreign Direct Investment (FDI), %GDP

Source: Author processing, 2013

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Table 60: ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	38.496	1	38.496	17.243	.004[a]
	Residual	15.628	7	2.233		
	Total	54.124	8			

a. Predictors: (Constant), Government Consumption (GC), % GDP

b. Dependent Variable: Net Foreign Direct Investment (FDI), %GDP

Source:Author processing, 2013

Table 61: Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	9.256	1.746		5.303	.001
	Government Consumption (GC), % GDP	-.130	.031	-.843	-4.152	.004

a. Dependent Variable: Net Foreign Direct Investment (FDI), %GDP

Source:Author processing, 2013

Table 62: Residuals Statistics[a]

	Minimum	Maximum	Mean	Std. Deviation	N
Predicted Value	-.5211	5.0695	2.3089	2.19362	9
Residual	-1.78923	2.95654	.00000	1.39768	9
Std. Predicted Value	-1.290	1.258	.000	1.000	9
Std. Residual	-1.197	1.979	.000	.935	9

a. Dependent Variable: Net Foreign Direct Investment (FDI), %GDP

Source:Author processing, 2013

Figure 27: Histogram

Histogram

Dependent Variable: Net Foreign Direct Investment (FDI), % GDP

Mean = 8.51E-16
Std. Dev. = 0.935
N = 9
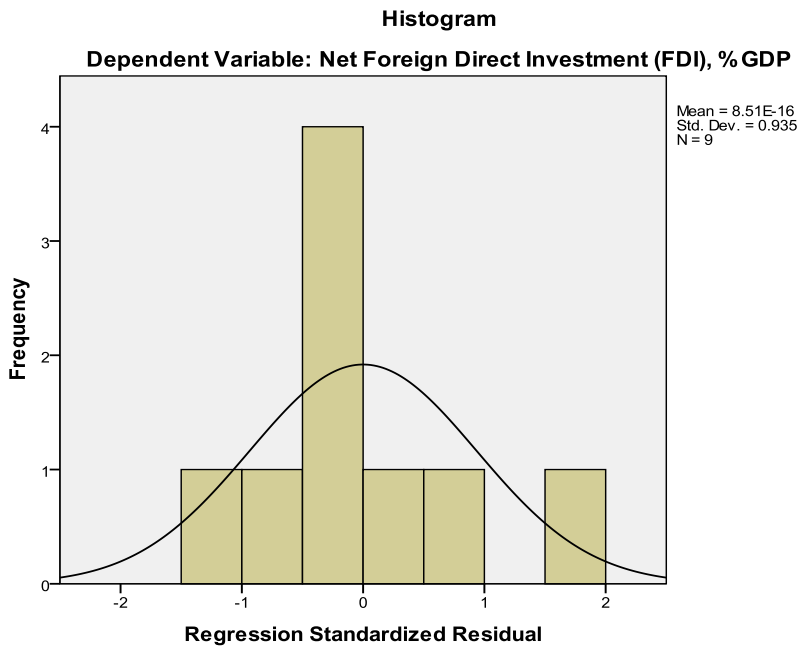
Source: Author processing, 2013

Figure 28: Normal P-P Plot of Regression Standardized Residual

Normal P-P Plot of Regression Standardized Residual

Dependent Variable: Net Foreign Direct Investment (FDI), % GDP
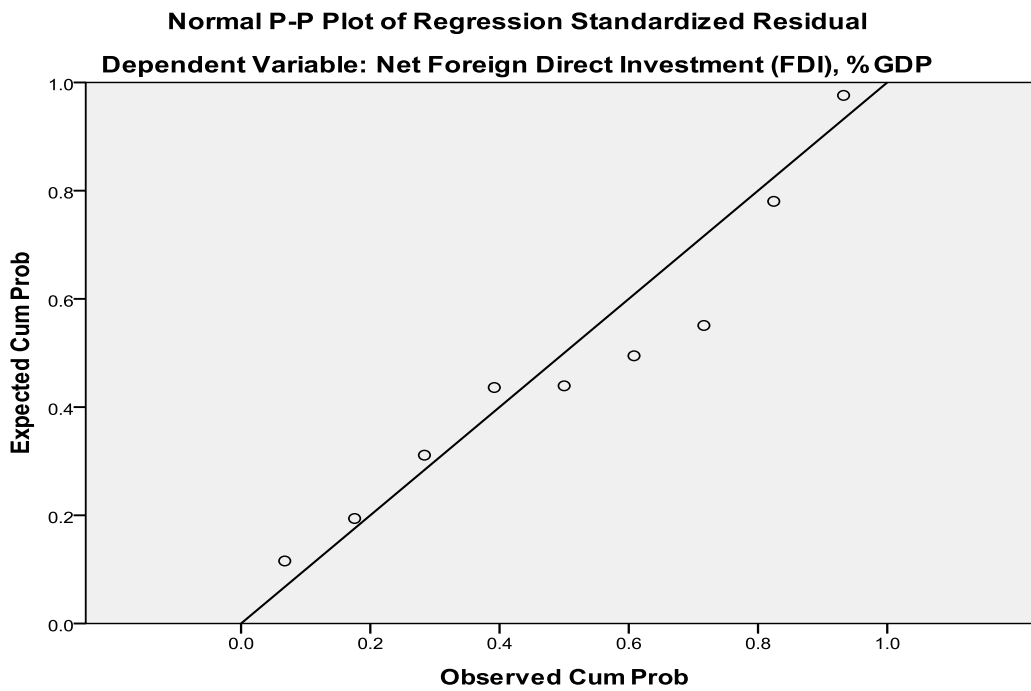
Source: Author processing, 2013

Determining the relationship between Government Consumption (GC) and FDIis essential since it shows which government expense has greater influence on FDI. The descriptive statistics on this relationship indicate that the means and standard deviations for Government Consumption (GC), as a % of GDP and Foreign Direct Investment (FDI), as a % of GDP are 53.4333and 0.4486 (means) and 16.87224and 1.96069 (standard deviations) respectively. However, correlation analysis indicates that there is significant correlation between Government Consumption (GC) and FDI at the 0.01 level (2-tailed). In addition, correlation analysis through a scatterplot indicates that the relationship between government consumption (GC) and Foreign Direct Investment (FDI) in Libya is negative and significant at 5% level of significance. It means if government consumption is increasing the foreign direct investment is decreasing and vice-versa. The same can be seen from scatter plot as well. From an economic point of view, the observed negative relationship is attributable to the fact that the government must look for ways to raise the needed finances (to fund its consumption) mostly through taxation which scares foreign investors hence the observed negative relationship is justified.

However, the regression equation obtained through regression analysis is:

FDI = 9.256-0.13*GC

The above equation shows that the model is significant at 5% level because the P-value of ANOVA table is less than 0.05. Both the interceptor as well as the scale variable is significant at 5% level. This model explains the 71.1% of the variation in FDI. If the GC is zero at some point then FDI will be 9.256 and if there is an increase in GC, then FDI will decrease by 0.13 times. The residuals are also normally distributed as shown by the histogram and normal p-p plot.

Relationship between government Investment (GI) and FDI

Descriptive Statistics**:**

Table 63: Descriptive Statistics

	Mean	Std. Deviation	N
Net Foreign Direct Investment (FDI), %GDP	0.4485999	1.96069	9
Government Investment (GI), % GDP	17.4222	6.53926	9

Source:Author processing, 2013

Correlation Analysis:

Table 64: Correlations

		Net Foreign Direct Investment (FDI), %GDP	Government Investment (GI), % GDP
Net Foreign Direct Investment (FDI), %GDP	Pearson Correlation	1	.748[*]
	Sig. (2-tailed)		.020
	N	9	9
Government Investment (GI), % GDP	Pearson Correlation	.748[*]	1
	Sig. (2-tailed)	.020	
	N	9	9

*. Correlation is significant at the 0.05 level (2-tailed).

Source:Author processing, 2013

Figure 29: Scatterplot
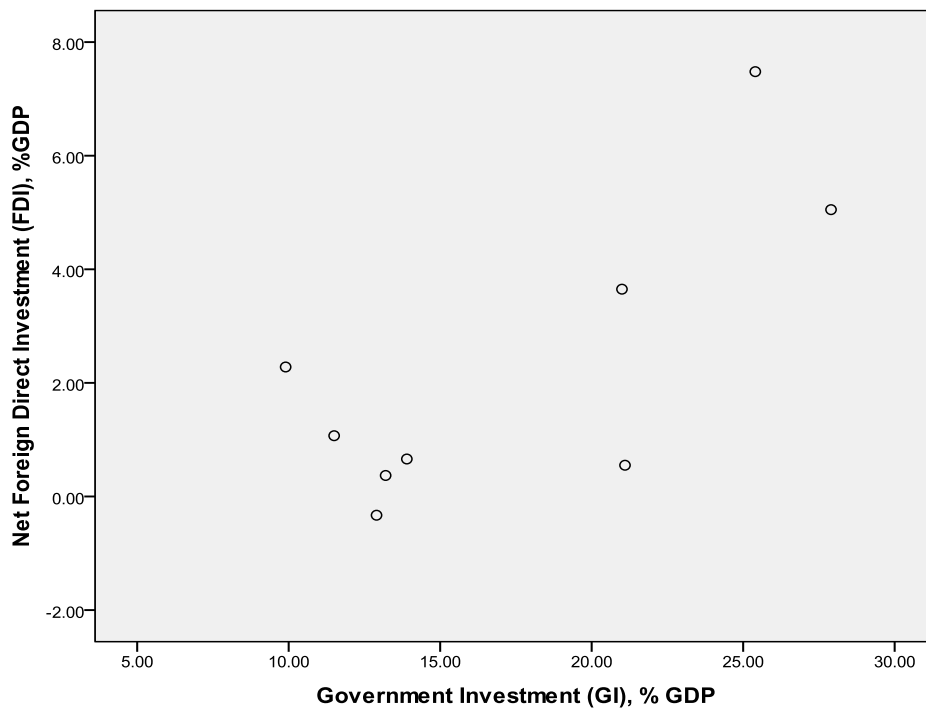
Regression Analysis:

Table 65: Variables Entered/Removed[b]

Model		Variables Entered	Variables Removed	Method
dimension0	1	Government Investment (GI), % GDP[a]	.	Enter

a. All requested variables entered.

b. Dependent Variable: Net Foreign Direct Investment (FDI), %GDP

Table 66: Model Summary[b]

Model		R	R Square	Adjusted R Square	Std. Error of the Estimate
dimension0	1	.748[a]	.560	.497	1.84541

a. Predictors: (Constant), Government Investment (GI), % GDP

b. Dependent Variable: Net Foreign Direct Investment (FDI), %GDP

Table 67: ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	30.285	1	30.285	8.893	.020[a]
	Residual	23.839	7	3.406		
	Total	54.124	8			

a. Predictors: (Constant), Government Investment (GI), % GDP

b. Dependent Variable: Net Foreign Direct Investment (FDI), %GDP

Source:Author processing, 2013

Table 68: Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-2.875	1.844		-1.559	.163
	Government Investment (GI), % GDP	.298	.100	.748	2.982	.020

a. Dependent Variable: Net Foreign Direct Investment (FDI), %GDP

Source:Author processing, 2013

Table 69: Residuals Statistics[a]

	Minimum	Maximum	Mean	Std. Deviation	N
Predicted Value	.0707	5.4264	2.3089	1.94567	9
Residual	-2.85317	2.79742	.00000	1.72622	9
Std. Predicted Value	-1.150	1.602	.000	1.000	9
Std. Residual	-1.546	1.516	.000	.935	9

a. Dependent Variable: Net Foreign Direct Investment (FDI), %GDP

Source:Author processing, 2013

Figure 30: Histogram

Histogram

Dependent Variable: Net Foreign Direct Investment (FDI), %GDP

Mean = 3.05E-16
Std. Dev. = 0.935
N = 9
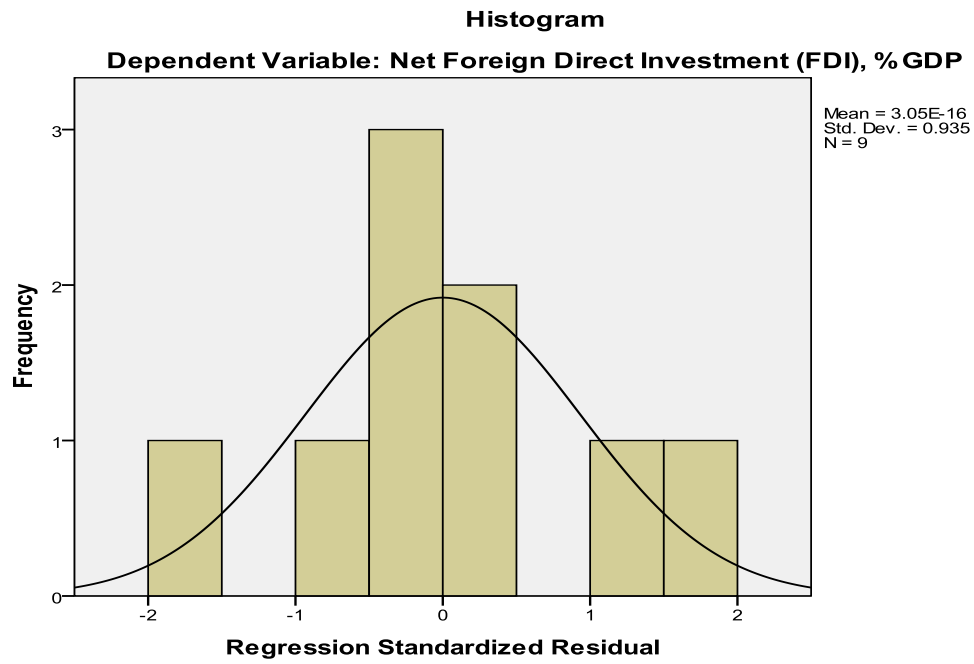
Source:Author processing, 2013

Figure 31: Normal P-P Plot of Regression Standardized Residual
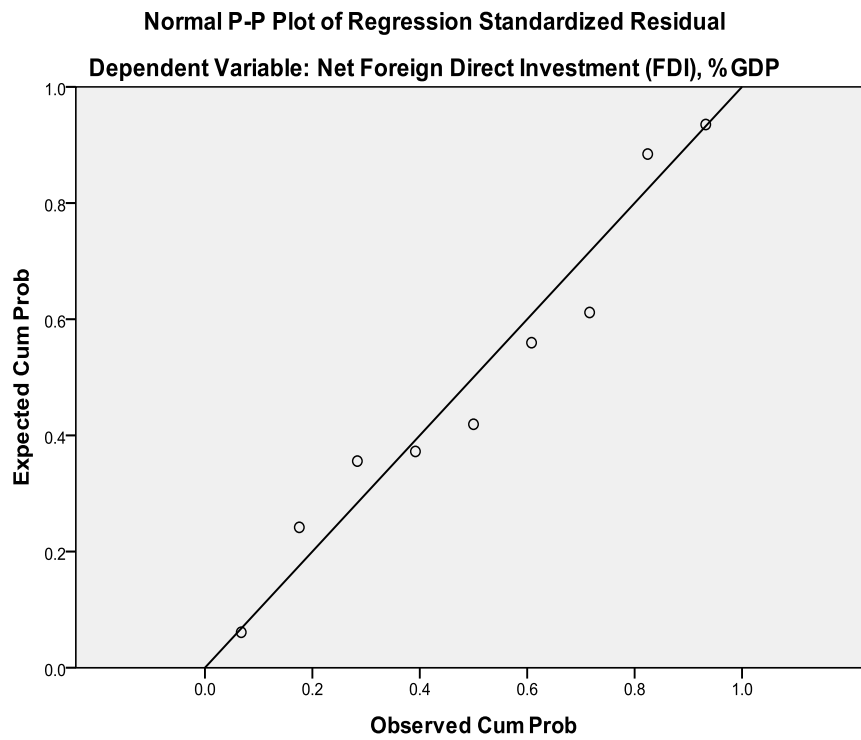
Normal P-P Plot of Regression Standardized Residual

Dependent Variable: Net Foreign Direct Investment (FDI), %GDP

Source:Author processing, 2013

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Determining the relationship between Government Investment (GI) and FDIis essential since it shows which government expense has greater influence on FDI. The descriptive statistics on this relationship indicate that the means and standard deviations for Government Investment (GI), as a % of GDP and Foreign Direct Investment (FDI), as a % of GDP are 17.4222and 0.4486 (means) and 6.53926and 1.96069 (standard deviations) respectively. However, correlation analysis shows that there is significant correlation between Government Investment (GI) and FDI at the 0.05 level (2-tailed). Moreover, a scatter plot shows that the relationship between Government Investment (GI) and Foreign Direct Investment (FDI) in Libya is positive and significant at 5% level of significance. It means if government Investment is increasing the foreign direct investment is also increasing and vice-versa. The same can be seen from scatter plot as well. From an economic perspective, this is attributed to the fact that government investments push the government to improve economic climate through improved business environment and infrastructure. In turn the improved economic climate attracts substantial FDI.

However, when regression analysis is considered the regression equation is:

FDI = -2.875+0.298 *GI

This shows that the model is significant at 5% level because the P-value of ANOVA table is less than 0.05. The scale variable is significant at 5% level but interceptor is not significant at 5% level. This model explains the 46% of the variation in FDI. If the GI is zero at some point then FDI will be -2.875 and if there is an increase in GI, then FDI will increase by 0.298 times. The residuals are also normally distributed as shown by the histogram and normal p-p plot. This confirms the stated hypothesis that there is significant relationship between Government Investment (GI) and Foreign Direct Investment (FDI) in Libya.

Therefore, an evaluation of the two types of government expenses separately show that increased government consumption negatively affects FDI while increased government investments positively affect FDI. Hence in order to improve FDI in Libya, the government is supposed to significantly its investments for improved economic climate in terms of providing conducive business environment as well as improving infrastructure.

Table 70: The Thesis Results

HN	regression equation	Important of the relationship	Impact	Accept or reject of the hypothesis
1.CTR & FDI	FDI=-482937 +33641.4*CTR	insignificant	Positive	Rejected
2.CR & FDI	FDI= -2847857.76+65447.1*CR	significant	Negative	Accepted
3.HC & FDI	FDI = -3189428.7+1.8*HC	significant	Positive	Accepted
4.GDP & FDI	FDI = -307893.9+19.1*GDP	significant	Positive	Accepted
5.GBS&FDI	FDI = 0.847 +0.103*GBS	insignificant	Positive	Rejected
6.GEX & FDI	FDI = 12.699-0.147*GEX	significant	Negative	Accepted
7.1.GC & FDI	FDI = 9.256-0.13*GC	significant	Negative	Accepted
7.2. GI &FDI	FDI = -2.875+0.298 *GI	significant	Positive	Accepted

CHAPTER IX: CONCLUSION AND RECOMMENDATIONS

It has been determined that fiscal policy plays an essential role in influencing the flows of FDI both into and outside a country. However, when the fiscal policy is favourable more FDI is attracted leading to achieved of the benefits associated with FDI such astechnology transfer, providing job opportunities for local employment, participation in financing of new projects, and benefiting from foreign experiences. It has also been observed that foreign investors will open new markets thereby helping them towards building new relationships and networks with peoples from various cultures. Moreover, the FDI phenomenon is twofold where apart from host country (FDI recipient) benefiting from FDI, foreign investors also benefit from raw materials, cheap labour and available market. However, investment climate has also been observed to play a crucial in determining whether a country will attract FDI, for instance, despite Libya's attempts to attract FDI by embarking on economic reforms and announcing its intent to attract FDI did not yield much success initially even though substantial FDI was attracted later.

An in depth correlational analysis in order to investigate the direction and strength of relationships between the FDI (dependent variable) and fiscal policy factors (independent variables) as well as determining the impact of the fiscal policy factors on FDI in Libya was the greatest motivation to carry out this study. Therefore, annual data on Libya's dependent variable (FDI) and independent variables (fiscal policy factors) such as country risk, market size (GDP), human capital, government budget surplus, government expenses and corporate income tax rates between 2000 and 2010, was used to determine the relationships that exist between the study variables in order to provide an effective way of testing the study hypotheses and highlighting of the study conclusions and recommendations. The study findings shows that fifth hypotheses (H2, H3, H4, H6 and H7) out of the seventh hypotheses stated in beginning of the studywere confirmed while two hypotheses (H1 and H5) were rejected..Both correlational analysis and regression analysis results facilitated by a simple linear regression model as well as graphical representations of the study data through scatterplots and histograms confirms the existence of significant positive or negative relationships between the FDI and CR , HC, GDP, GEX, GC and GI in Libya.

This is clearly evident that foreign direct investment (FDI) in Libya are likely to be influenced either positively or negatively by the fiscal policy parameters, and implying that fiscal policy is one of the greatest determinants of foreign direct investment (FDI) in Libya.

Moreover, apart from using fiscal policy alone to positively influence or improve foreign direct investments (FDIs) in Libya there are other ways that can be recommended for significant attraction of FDI in the country:

1. Libya should provide appropriate investment climate for attraction of FDI; while reforming one part of economy including establishing a law for encouraging FDI and letting the other legislations in same situation aimed at safeguarding any FDI made in the country. Moreover, developing appropriate fiscal incentives would be sufficient to attract substantial FDI. This implies that Libya must work towards reforming economic and political policies in order to attract substantial FDI;

2. Libya should also reform the banking system in general, since the revision of the banking system in Libya will ensure that commercial banks operates freely without direct control from external authorities as it is in Libya where they work under the authority of the central bank as the coffers of money and payment of salaries to people. Creation and improvement of a favourable investment climate requires economic reform into the banking system;

3. Facilitating entry procedures for foreign investors, facilitating free movement of money to and from Libya, as well as easy procedures are important factors for foreign direct investment (FDI)attraction, also, eradication of corruption and bribery as well as administrative stability remains the most important factor for attracting FDI;

4. Intensify advertising of Libya as a possible foreign direct investment (FDI) destination to make new investors know potential investment opportunities in Libya. Therefore, there is need to take advantage of all the media in the promotion of investment;

5. Ensuring that the country gains the confidence of foreign investors through activating and more reforming the laws to be more attractive to foreign investors, whereas the laws that arrangement Law No. 5 of the year (1997) for Promotion of Investment of Foreign Capital, as Amended by Law No. 7 of the year (2003), then law No. 9 of the

year (2010) which has integrated domestic investment and foreign investment and that in itself is a legislative defect might be make the investors take backward step.

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APPENDIX

Appendix 1: General government final consumption expenditure

Indicator Name	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
General government final consumption expenditure (current US$)	6.69E+09	7.06E+09	6.49E+09	3.21E+09	3.28E+09	4.36E+09	5.19E+09	6.04E+09	8.33E+09	8.66E+09
General government final consumption expenditure (current LCU)	3.10E+09	3.62E+09	3.93E+09	4.08E+09	4.20E+09	5.67E+09	7.00E+09	7.74E+09	1.02E+10	1.06E+10
General government final consumption expenditure (constant 2000 US$)		7.06E+09								
General government final consumption expenditure (annual % growth)										
General government final consumption expenditure (constant LCU)										
General government final consumption expenditure (% of GDP)	21.93932	20.82769	22.82508	16.17857	13.63412	13.07258	11.78838	10.7	11.6	9.3

Appendix 2: Human Capital

Indicator Name	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Labor participation rate, female (% of female population ages 15+)	27.4	28.2	28.9	29.4	29.9	30.2	30.4	30.5	30.6	30.5	30.4
Ratio of female to male labor participation rate (%)	37.53425	38.41962	39.1069	39.56931	39.97326	40.10624	40.15852	40.02625	39.94778	39.71354	39.53186
Labor participation rate, male (% of male population ages 15+)	73	73.4	73.9	74.3	74.8	75.3	75.7	76.2	76.6	76.8	76.9
Labor participation rate, total (% of total population ages 15+)	50.9	51.4	52	52.4	52.8	53.1	53.5	53.8	54	54	53.8
Labor force, female (% of total labor force)	26.09826	26.67865	27.10618	27.43984	27.75569	27.91832	27.90688	27.8374	27.83879	27.82727	28.01249
Labor force, total	1801054	1872069	1943603	2005730	2067876	2127433	2193699	2257629	2315303	2356990	2379116