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HAROLD PUPKEWITZ GRADUATE SCHOOL OF BUSINESS

Tax Incentives and Foreign Direct Investment: The Namibian Experience

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God Bless!

Table of Contents

1.Introduction.....	1
1.1 Background of the Study.....	1
1.2 Statement of the Research Problem.....	3
1.3 Objectives of the Study.....	4
1.4 Significance of the Study.....	5
1.5 Research Approach and Limitations.....	5
2.Literature Review.....	7
2.1 Introduction.....	7
2.2 Theoretical Literature Review.....	7
2.3 Empirical Literature Review.....	15
2.4 Chapter Summary.....	21
3.Overview of the Investment Incentives Framework of Namibia	
.....	23
3.1 Introduction.....	23
3.2 Types of Investment Incentives Offered by Namibia.....	24
3.3 FDI Inflow to Namibia versus the Region and World.....	30
3.4 Chapter Summary.....	33
3.5 Theoretical Framework.....	34
4.Methodology.....	36
4.1 Introduction.....	36
4.2 Explaining the methodology.....	36
5.Determining the Impact of Tax Incentives on FDI in Namibia.....	43
5.1 The Impact of Corporate Tax Rate on FDI Flows in Namibia.....	43
5.2 Assessing the Impact of Other Factors Identified as Important for Attracting FDI.....	46
5.3 Assessing the Cost of Tax Incentives Offered by Namibia.....	61
6.Study Conclusions, Limitations and Recommendations.....	68
6.1 Conclusions.....	68
6.2 Study Recommendations.....	71
6.3 Study Limitations and Resulting Recommendations.....	74
6.3.1 Lack of available data.....	74
6.3.2 Poor response from companies.....	74
6.3.3 Recommendations resulting from the study limitations.....	74

References.....	76
Appendix.....	79

List of Tables

Table 1 Namibia's Share in Total FDI inflows to the Continent and Region.....	43
Table 2 Namibia's FDI Composition Trends.....	57
Table 3 Total exports and selected export items.....	60
Table 4 Correlations between total foreign investment as a percentage of GDP and natural resources exports as percent of total exports.....	61
Table 5 Results of chi-square test.....	62
Table 6 Sectors which saw FDI inflows.....	63
Table 7 Namibia's Foreign Direct Investment, Gross Fixed Capital Formation and GDP.....	65
Table 8 Correlations between total foreign investment as a percentage of GDP and total foreign investment as a percentage of gross fixed capital formation..	66
Table 9 Results of chi-square test.....	66
Table 10 Correlations between total foreign investment as a percentage of GDP and investors protection index.....	67
Table 11 Results of chi-square test.....	68
Table 12 Correlations between total foreign investment as percentage of GDP and the number of days to start a new business in Namibia.....	69
Table 13 Results of the chi-square test.....	70

Table 14 Correlations between total foreign investment as percentage of GDP and the Employment Rigidity Index.....	71
Table 15 Chi-square test results.....	71
Table 16 Correlations between the value of investment approvals (INVAPROV) and subsequent real gross fixed capital formation (RGFCF).....	76
Table 17 Chi-square test results.....	76
Table 18 Employment by sector.....	78

List of Figures

Figure1: FDI developments in Namibia during 2000-2010.....	41
Figure 2: Trend in FDI inflows and special corporate tax rates.....	56

Abbreviations

BoN	Bank of Namibian
CMA	Common Monetary Area
ECCU	Eastern Carribean Currency Union
EPZ	Export Processing Zone
FIAS	Foreign Investment Advisory Service
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GFCF	Gross Fixed Capital Formation
IMF	International Monetary Fund
INVAPPROV	Value of Investment Approvals
IPPR	Institute for Public Policy Research
MNEs	Multinational Enterprises
MTI	Ministry of Trade and Industry
NAMDEB	NamibiaDeBeers Diamond Mining Company
NDP4	Namibia Development Plan Four
NIC	Namibia Investment Center
N\$	Namibia Dollar
NSA	National Statistics Agency
ODC	Offshore Development Company
OECD	Organisation for Economic Cooperation and Development
RGFCF	Real Gross Fixed Capital Formation
SACU	Southern African Customs Union
SADC	Southern Africa Development Community

UNCTAD	United Nations Committee on Trade and Development
UNDP	United Nations Development Programme
UNECA	United Nations Economic Commission for Africa
U.S	United States of America
US\$	United States of America Dollar

Abstract

This study poses a general question of whether or not foreign direct investment (FDI) inflows have come to Namibia because of the tax incentives offered to foreign investors; and thus whether or not offering such incentives has been beneficial to the country. To answer this question and as dictated by the availability of data, the study reviewed the FDI inflows into Namibia and attempted to assess the benefits and costs through an investigation of related indicators and making inferences. Use has been made of secondary data and sources while a survey of foreign investors was also administered, though this yielded a very low response rate. The study found that the abundance of natural resources in Namibia might have been the key driver in attracting FDI. The tax incentives offered as well as other factors that usually determine the prevailing investment environment of a country might have played a complimentary role. Other factors include investors' trust in the country's economy, the functioning of government and availability of good infrastructure, which are important considerations for investors when selecting a location for their investment. While the investment environment of Namibia is generally sound, the study suggests that it be perfected by closing the gaps that have been identified through assessments such as those by the World Doing Business and World Competitiveness Reports of the World Bank. The paper also identifies the need to align the fiscal incentives framework with national aspirations as set out in the country's fourth National Development Plan (NDP4) and Vision 2030 so as to ensure a coherent national framework that facilitates the achievement of national objectives. Periodic reviews of fiscal incentives policies are also important to redirect investment incentives to deserving sector and/or projects when necessary.

Key words: Tax incentives, FDI, Namibia

1. Introduction

1.1 Background of the Study

Several international and regional development institutions and bodies such as the International Monetary Fund (IMF), World Bank, United Nations Development Programme (UNDP) and United Nations Economic Commission for Africa (UNECA) have been advocating the importance of foreign direct investment (FDI) in the development of a country for decades now. The belief has been that the inflow of FDI would result in enormous developmental benefits, particularly for developing countries.

The benefits usually associated with FDI have been said to include the creation of new job opportunities, technological transfer and know-how, improved efficiencies of domestic industries, increased foreign exchange earnings through more trade between the domestic economy and the rest of the world and supporting human capital formation in the host country. In the quest to reap these perceived benefits and spillovers associated with FDI, coupled with the commitment to develop their countries, developing countries have been looking for ways to attract and increase the flow of FDI. Various initiatives have been taken in the process, including improving their investment environments (such as infrastructure), liberalising their economies and providing various incentives to potential investors (Tessama, 2008).

Generally though, offering foreign investors investment incentives in general and tax incentives in particular to attract FDI has been a debatable issue. Based on the abovementioned perceived benefits associated with FDIs, some economists have been in favour of the provision of incentives and have argued that governments should do everything possible to attract FDI. Others have either argued against the provision of incentives and have advanced views as to why governments should not offer tax

incentives to attract foreign investment. Amongst others, the following arguments summarised by Wells, Allen, Morisset and Pirnia (2001) have been advanced: that FDI may have a negative impact on the productivity of local firms; that the cost to the public for incentives may exceed the additional benefits created by the investment; that there is a great possibility that the decision made by investors on the selection of locality does not only depend on incentives but on many other factors that might weigh higher than incentives. They also argue that incentives have had little (if any) effect on the total foreign investment made worldwide; and that in the aggregate, incentives create a net transfer from taxpayers to investors. They have further argued that in the case of foreign investors in developing nations, this transfer would be primarily from a poor country to a richer one. Countries have, despite the above arguments, continued offering incentives to attract FDI.

Typically Namibia, as a country on the path of building her economy, became eager to attract FDI after attaining her independence in 1990 so as to meet her investment needs that would contribute to her developmental efforts. Accordingly, the Government introduced various investment policies and programmes, which included the Foreign Investment Act of 1990, tax free export processing zone (EPZ) regime and the special incentives for manufacturing enterprises. The questions that arise, however, are: how effective the incentives offered by Namibia have been, i.e. how far have they succeeded in attracting FDI or at least the majority of it to Namibia, what have been the benefits derived from the investment that came to the country, and to what extent the extension of incentives may have burdened the fiscal budget of the country? It is against this background that the proposed study will attempt to appraise the FDI investment incentive regime of Namibia (in particular, tax incentives) to

determine whether the country's efforts in offering tax incentives have been worth the related costs incurred.

1.2 Statement of the Research Problem

While FDI attraction might be important to a country; and countries providing fiscal incentives usually believe that such incentives will yield investments that will be beneficial to their economies, sometimes the costs of such incentives do significantly exceed their level of return to the country. The critique has been that developing countries in general have been following a conventional development approach of concentrating on the benefits associated with FDI and not being so much concerned about the costs that may also be associated with it. In other words, much emphasis has been placed on the attraction of FDI, with little effort to understanding how the host economy could optimise the benefits from foreign investment. Besides, an analysis of costs and benefits is most of the times not undertaken to determine the exact situation before an FDI promotional exercise is embarked upon, and therefore countries often provide these incentives at the expense of an efficient allocation of their public resources domestically.

After independence, Namibia introduced policies and programmes to attract foreign investment. It managed to attract FDI to a certain extent, mainly in the mining, retail and fishing sectors. Just as the above general critique regarding tax incentives goes, it has been alleged that the costs of offering fiscal incentives to foreign investors by the Namibian Government might have been higher than the benefits derived from it. However, this critique has not been empirically confirmed; nor has the extent of such costs relative to benefits been fully quantified. Some work done by Akinkugbe (2006) in an attempt to measure the benefits and costs of FDI in Namibia had limitations of methodology applied as well as data, time and cost, such

that it could not fully capture the benefits and costs of FDI in Namibia. In fact, Akinkugbe recommended that further work be done based on another model that would fully capture the benefits and costs of FDI in Namibia. This study is an attempt to complement that work through specifically looking at the experience of Namibia with FDI attraction, from a perspective of what the impact of tax incentives has been.

1.3 Objectives of the Study

In line with the above research problem, the objectives of this study are to:

- i. assess the experience of Namibia with tax incentives and determine the effectiveness of the tax incentives provided by the Namibian Government to foreign investors in an attempt to attract FDI.
- ii. determine, through relevant indicators, what the position of Namibia has been so far in terms of the costs and benefits of providing such incentives, i.e. it relates the cost indicators of FDI incentives to the benefits derived from such investments and makes some concluding remarks and recommendations on the aspect.

This is done through attempting to answer the following questions as well as running relevant tests where possible as outlined under the methodology section.

- i. Has there been an increase in FDI flow to Namibia because of the tax incentives offered?
- ii. At what cost were the incentives provided (i.e. the costs that have been borne by the fiscus to support the incentives so provided) and how do they relate to the benefits derived from them?
- iii. Are there any other factors that played a role in attracting foreign direct investment to Namibia?

- iv. What has been the impact of FDI on the socio-economic welfare of Namibia, i.e. spillover effects?
- v. Is there a need for appropriate policy alternatives to FDI attraction for Namibia?

1.4 Significance of the Study

Since the intention of the study is to estimate the effectiveness of the fiscal incentives offered by the Namibian Government to foreign investors since independence, it is believed that the significance of the burden the economy might have endured (i.e. the costs), relative to the benefits, would expose what level of efficiency has been achieved in Namibia in extending tax incentives. This determined level of efficiency is especially important for a country which is under continuous socio-economic pressure due to high unemployment and poverty rates and hence the need for Namibia to reposition herself and grow her economy. This important finding can give policy guidance in terms of the future provision of fiscal incentives and/or any other forms of subsidy schemes to further attract FDI to Namibia. The findings of the study are also hoped to provide insight to other developing countries, especially African countries that might find themselves in a similar situation as Namibia, in terms of how to reduce the costs of providing fiscal incentives for FDI attraction while still increasing the benefits derived from it. The findings could thus encourage and promote countries to undertake proper analysis of the expected costs and benefits first before extending incentives for foreign direct investment.

1.5 Research Approach and Limitations

The research is based on a desk review of the theoretical and empirical literature on tax incentives and FDI. Data sources for empirical testing came from the

administrative records of Government agencies/ministries such as the Bank of Namibia (historical annual data for the levels of FDI), Namibia Statistics Agency, formerly Central Bureau of Statistics (on gross fixed capital formation, GDP, exports, imports), the Investment Centre of the Ministry of Trade and Industry (investment approvals), etc. Other sources such as the reports and databases of the Southern Africa Development Community (SADC), World Bank, OECD, UNCTAD, UNDP, etc. have also been used for relevant information and statistics, especially for comparative purposes, while various other, reports, websites and internet sources have also been utilised as input into the research. A survey of companies with FDI in Namibia was administered, though yielded a very low response rate.

The research limits itself to the macro-study and analysis of the overall impact of tax incentives on the Namibian economy and does not look into individual company cases, i.e. it does not look into the impact made by specific companies to which tax incentives were extended, except in limited cases where examples are provided. Other significant limitations to the analysis are the unavailability of relevant information needed to run relevant tests as well as the fact that there has not been any tax incentive reform relating to attracting FDI since its introduction in 1993.

The rest of the study is structured as follows: the following chapter contains a review of the literature, while chapter three provides an overview of the investment incentives framework of Namibia and a comparison of FDI flows to Namibia against the region and the rest of the world. Chapter four provides an explanation of the methodology employed, followed by the analysis of the estimated results of what the effect of the tax incentives on FDI have been in Namibia which is contained in chapter five. The conclusions, study limitations and recommendations of the study are presented under chapter six.

2. Literature Review

2.1 Introduction

The role of foreign direct investment (FDI) in the development process of an economy has been generally agreed upon. For this reason countries around the globe, both developed and developing have engaged in efforts to attract FDI. The challenges faced by countries, especially developing countries in Africa is how to attract foreign direct investment. Fiscal incentives have been the most popular instrument for attracting FDI, and countries have thus been competing using that instrument. The topic of FDI and tax incentives has been widely researched and documented, and below is a review of some of the documented views and findings.

2.2 Theoretical Literature Review

Over the last few decades, foreign direct investment (FDI) is said to have dominated economic literature, especially in the area of development economics. Further with globalisation of the international economy in the 1990s, the importance of FDI increased and was considered by many economists to be one of the leading motivations for its dominance (Massoud, 2003). A general view in literature on FDI has been that FDI plays a major role in the economic development of the host country through the benefits associated with it (Hanson, 2001). According to Hanson, these include, amongst others, the creation of new employment, technological transfer and know-how, increased trade integration with the rest of the world. This has led countries of the world; emerging economies in particular, to engage in FDI attraction efforts in order to meet their investment and development needs. Increased integration into the world economy that FDI is deemed to offer, is believed to result in potential economic growth (Massoud, 2003).

According to Hartman (1984), FDI can take a number of forms; and although generally perceived as investment in a country by a new foreign entrant, the majority of FDI actually occurs within established foreign affiliates. Hartman indicates that the most explicit is the transfer of funds abroad by a parent firm, either as loans to or equity investments in subsidiaries; and that the retention of earnings abroad by foreign subsidiaries also raises the subsidiary stake of the parent firm in a similar manner.

Generally though, the subject of FDI is a complex one. Issues of why FDI exists and what motivates FDI have been debatable, such that there has not been a unified theoretical explanation for FDI (Denisia, 2010). Various theories have been developed aimed at explaining the existence of and motivation for FDI. Denisia (2010) lists these to include *the Production Cycle Theory* developed by Raymond Vernon in 1966, which analyses the relationship between the product life cycle and possible FDI flows; *the Theory of Exchange Rates on Imperfect Capital Markets* by Cushman 1985 that looks at the relationship between FDI flows and exchange rate changes; *the Internalization Theory* by Buckley and Casson brought to the fore in 1976 that aims to answer the question of why firms do not just sign contracts with a subcontractor in a foreign country instead of making FDI and the *Eclectic Paradigm Theory* originating from Dunning's work in 1976, referred to as the OLI theory. The OLI theory is a mix of three different theories of FDI which analyses the investing firm's decisions on the basis of ownership advantages (O), localisation advantages (L) and internalisation advantages (I). The author has considered the Internalisation Theory and the Eclectic Paradigm Theory to be the most relevant to the subject matter of this study and they are therefore summarised below. The summary borrows from the work by Denisia (2010).

2.2.1 The internalisation theory of FDI.

This theory intends to answer the question of why firms do not just sign contracts with a subcontractor in a foreign country instead of making FDI. Denisia (2010) explains that transnational companies organise their internal activities so as to develop specific advantages, which they then can exploit. The main issue of this theory is the fact that contracting out is risky, i.e. transferring specific capital outside the firm and revealing the proprietary information might result in a problem for the firm, especially in cases where the contracted agent decides to interrupt the contract and use the technology to compete with the mother company or in the case where the agent through its operations damages the brand reputation of the firm. As such, the firm could be more comfortable with engaging production activities itself in a foreign country and hence invests in that country. This theory therefore aims to explain the growth of transnational companies and their motivations for achieving foreign direct investment by recognising the existence of the aspect of market imperfection. The above aspects covered by this theory are relevant to this study which aims to assess the extent at which tax incentives have induced investors to invest in Namibia.

2.2.2 The eclectic paradigm theory of FDI.

The Eclectic Theory is explained by Denisia (2010) as a mix of three different theories of foreign direct investments and analyses FDI based on the following: ownership advantages (O), localisation advantages (L) and internalisation advantages (I). It is therefore referred to as the OLI theory. Denisia provides the essence of each of the three components as summarised below.

Ownership advantages (O) postulates that some firms have firm-specific intangible assets (such as human capital, patents, brands, technologies, etc.) which can be replicated in different countries at low costs, and which might yield higher incomes

at reduced costs; hence the motivation for entering other countries in the form of FDI. However because additional cost might be faced by the investing company, there is a need for the company to have some specific characteristics to be able to enter a foreign country successfully. According to Denisia, these characteristics might be in the form of certain monopolistic advantages, technology to contain innovation as amongst others such as economies of scale and greater access to financial capital.

The Location (L) component of the theory advances that location advantages of different countries are key determinant factors of host countries for FDI of transnational corporations (TNCs). Country specific advantages can range from economic benefits such as factors of production, transport costs, telecommunications and market size; political factors including government policies on FDI flows, and social factors such as the appreciation for cultural diversity and attitude towards strangers. However, it is important to mention that the ability of investing firms to take advantage of various location advantages is affected by their specific characteristics. As such, specific location advantages may have different values for specific firms and hence location choices by various firms are affected accordingly, i.e. they cannot be identical across all TNCs.

The third component of the Eclectic Theory, the internalisation (I), on the other hand, looks at ways in which the firm can exploit its powers. It explains that the firm would want to engage in foreign production instead of franchising or licensing if cross-border market internalisation benefits are higher. What is important to note with regards to the Eclectic Paradigm Theory is that OLIs are different from company to company, and also depend on context and reflect the economic, political and social characteristics of the host country. As such, the objectives and strategies of firms, the magnitude and pattern of production will depend on the challenges and opportunities

offered by different types of countries. Nevertheless, Kuşluvan (1998) concludes that the OLI theory is a better framework and can form a single general theory of MNEs as it has features encompassing all other theories as well as the analytical power for examining the motivation for firms going abroad, the reasons for different forms of investment abroad and why firms investing abroad are able to be successful. All these factors underlying the OLI theory are thus relevant aspects to consider in the process of determining whether or not Namibia has attracted FDI because of the tax incentives offered or because of other factors, which is the intention of this study as highlighted above.

Literature has, however, also identified the existence of weaknesses in all of the FDI theories, in that each of them (i.e. the ones discussed above and others) could only partly explain some of the aspects pertaining to the existence and motivation of FDI, and thus the existence of no unified theory (Denisia, 2010). However, the importance of FDI to the economies has generally been agreed upon. The question is what the countries should do and how they should go about attracting FDI while ensuring that they derive maximum benefit and reduce inherent costs. Countries have been providing various incentives to attract FDI, but this study aims to limit itself to the extension of tax incentives.

2.2.3 Tax incentives as a tool to attract FDI.

The Organisation for Economic Cooperation and Development (OECD) has defined tax incentives offered by countries for FDI as “... measures designed to influence the size, location or industry of an FDI investment project by affecting its relative cost or by altering the risks attached to it through inducements that are not available to comparable domestic investors...” (OECD, 2003, p.12). More simplified, this definition implies that tax incentives aim at providing a more favourable tax

treatment to certain investment projects compared to what is granted to investment in general. As such, tax incentives tend to make a country attractive for foreign investment.

Before the 1990s, there was almost a consensus among economists that FDI was mainly attracted by strong economic fundamentals; market size and income level, skills, infrastructure and other resources that facilitate efficient specialisation of production, trade policies, and political and macroeconomic stability as other central determinants (Massoud, 2003). Investment incentives in all forms were seen as relatively minor determinants of FDI decisions. While the literature accepted that investment incentives might affect the investment decision in favour of one or several otherwise similar investment locations, the effects were considered only marginal. This started to change during the 1990s, as globalisation took its toll and made incentives a more important determinant of international investment decisions, due to the increasing competition among countries to attract FDI and thus offering incentives for that purpose (Massoud, 2003).

According to Massoud (2003) the widespread acceptance of the policy tenets of FDI has increased both temptation and pressure on countries to fully liberalise FDI regimes, consequently leading to rapidly changing FDI regimes in favour of attracting more FDI flows and thus to offering a wide-range of incentives to affect the size and location of FDI. Particular attention on attracting FDI seems to have been observed in emerging-market countries, given their relatively low domestic saving rates and the inefficient financial intermediaries which hinder strategies to finance growth and therefore creating a need for external financing; as well as the high risk concerns associated with portfolio investments which became apparent during the Asian financial crisis of 1997-98 (Massoud, 2003). Countries have thus been extending

subsidies to foreign companies, mostly multinational firms, in an effort to attract foreign direct investment. The most common forms these subsidies have taken are partial or complete exemptions from corporate taxes and import duties as well as the creation of special zones for exporting companies. However, just how effective the policies of promoting foreign direct investment have been, especially for the host country, has been an issue that has generated differing views; and as such the literature about the effectiveness of taxes on foreign direct investment has remained fairly inconclusive (Panagiota, 2010).

Although it is generally accepted that tax policies are able to influence the flow of FDI and that there are potential benefits to be derived by the host country, this ability has been argued to be based on the fact that all other determinants are equal sees this as a weakness in itself as countries have different regulations and other business policies, levels of skilled human capital, infrastructure, and market size. As such, while some economists have argued that providing investment incentives in general, and tax incentives in particular, to potential foreign investors does play a key role in the decision-making process of the location for their investment, others have argued that other factors of fundamental nature play a more important role than tax incentives (Wells et al, 2001).

According to Wells et al. (2001), two main arguments made against investment incentives are that incentives have little, if any effect on the total foreign investment that is made worldwide, and thus in the aggregate, incentives create a net transfer from taxpayers (or, in the case of indirect subsidies such as protection from imports, from consumers of the relevant product) to investors. In the case of foreign investors in developing nations, this transfer is primarily from a poor country to a richer one. The second argument identified by Wells et al is that even if it is the case that

incentives increase the total investment worldwide, the costs to the public for these incentives exceed any additional benefits that are created by the investment.

Literature on FDI incentives has also indicated that the effectiveness of incentives differs among types of investors or investments. It follows that location choices for export-oriented FDI are more likely to be affected by tax incentives than are those for foreign direct investments meant primarily to serve local domestic markets. A further argument is that an export-oriented FDI might be more concerned with the cost structure of production in its investment location than with market-seeking and natural resource-seeking FDI (Massoud, 2003). It is further argued that the co-location with another firm, i.e. agglomeration has the potential to increase the attractiveness of other investors (Wasylenko, 1999; Wheeler & Mody, 1992 as cited in Massoud, 2003). Massoud further quotes Friedman et al. (1992) on views that the effect of incentives on FDI depends on the type of FDI-incentives.

In line with the above arguments, an article published in the *Bulletin for International Taxation* by Easson (2001), indicates that conventional wisdom does not recommend tax incentives for investment, in particular for FDI. According to Easson, the view held almost universally by theorists and by the international bodies that advise on tax matters (such as the World Bank and IMF), is that tax incentives are bad in theory and in practice. He indicates that they are bad in theory principally because they cause distortions in that investment decisions are made that would not have been made without the inducement of special tax concessions, while they are bad in practice, being both ineffective and inefficient. Easson explains that tax incentives are ineffective in that tax considerations are only rarely a major determinant in FDI decisions; while they are inefficient because their cost, in terms of tax revenue foregone, often far exceeds any benefits they may produce. However, Easson also

noted that, many countries have been competing in offering tax incentives to foreign investors regardless of the advice against it, governments have developed national policies towards FDI and that investment incentives have become more important such that many countries will continue to offer tax incentives to investors. The following section provides some of the existing empirical findings on the topic.

2.3 Empirical Literature Review

Several studies have been carried out on the effectiveness and efficiency of tax incentives in attracting FDI. Up until the mid 1980s, research was primarily focused on understanding whether tax incentives were one of the key factors in attracting FDI (Zuo, 2009). Zuo's research work found that by using either selective surveys or time-series econometric analysis, early studies concluded that tax policy was one of the key factors in the decision-making process of Multinational Enterprises, but not a decisive one. Other later studies including the results of field research by Aharoni in 1966 (as cited in Morisset & Pirnia, n.d.) considered fiscal incentives, income tax exemption in particular, to be a weak stimulant. Morisset and Pirnia summarise the conclusions of the field research to have pointed to the fact that host government concessions did not bring about the decisions to invest. They quote one of the investors surveyed to have said: "Tax exemption is like a dessert; it is good to have, but it does not help very much if the meal is not there" (Morisset & Pirnia, n.d.). These studies however, had limitations in that many of them focused on highly aggregated FDI data across firms of all types and little attention was paid to differences across sectors. Therefore, the approach of much later studies recognised the need for an in-depth look at the role tax incentives play in investment decision-making processes of multinational enterprises (MNEs). This included doing an in-depth cost-and-benefit analysis of tax incentives so as to get insight of this fiscal policy.

The econometric tests mostly employed by existing literature on the area of tax incentives and FDI have also looked at time-series estimation of the responsiveness of FDI to variation in after-tax rates of return in host countries further indicates that studies of this type have consistently reported a positive correlation between levels of FDI and after-tax rates of return at industry and country levels. The other set of studies used are exclusively cross-sectional in nature, exploiting the very large differences in corporate tax rates around the world to identify the effects of taxes on FDI. This kind of econometric study provides ample evidence of the sensitivity of the level and location of FDI to its tax treatment. Most econometric studies have found that the different FDI incentives, whether tax incentives, financial subsidies or regulatory exemptions directed at attracting foreign investors can not be substituted for pursuing the appropriate general policy measures and focusing on the broader objective of encouraging investment regardless of source. Nevertheless, incentives can act as a supplement to an already enabling and attractive environment for investment or can act as compensation for proven market imperfections that cannot be otherwise addressed (OECD, 2003).

Furthermore, work done by Tanzi and Zee in 2001 on tax policies for developing countries indicated that while granting tax incentives to promote investment was common in countries around the world, evidence suggested that its effectiveness in attracting incremental investments above and beyond the level that would have been reached had no incentives been granted, was often questionable. The study indicated that tax incentives could be abused by existing enterprises disguised as new ones through nominal re-organisation, and therefore their revenue costs could be high. Moreover, foreign investors, which are the primary target of most tax incentives, base their decision to enter a country on a whole host of other factors (such

as natural resources, political stability, transparent regulatory system, infrastructure, and skilled workforce), of which tax incentives are frequently far from being the most important one (Tanzi & Zee, 2001). The study further posited that tax incentives could also be of questionable value to a foreign investor because the true beneficiary of the incentives may in the end not be the investor, but rather the treasury of his home country, especially when any income spared from taxation in the host country is taxed by the investor's home country.

Morisset (2003) through the World Bank's Private Sector Advisory Services' publication (Viewpoint), also indicates that the impact of tax incentives on FDI appeared to be ambiguous at first glance. Morisset deduced this from time-series econometric analysis and results of numerous surveys of international investors that showed that tax incentives were not the most influential factor for multinational corporations in selecting investment locations.

An interesting dimension to incentives and FDI was brought afore through the work of Tessema (2008), which looked at the threat to the realisation of socio-economic rights in Africa posed by the competition to attract FDI through tax incentives. Tessama indicated that the main problem in the deployment of tax incentives as a means of attracting FDI lay in the fact that, it is driven by political reasons, not economic ones. The study stated that in a political atmosphere dominated by concerns about economic vitality and jobs, elected officials face intense pressure to engage in the incentive competition; and that this was especially true for African countries, which are under continuous internal and external political pressure because of their fragile economies and extremely high unemployment rates. It concluded that under such conditions the absence of empirical evidence for the economic efficacy of tax incentives does little to quell the political enthusiasm of providing incentives even

if that would be at very high costs for the country. This provided a view on the whole politics behind tax incentives and the need for empirically determining the evidence of the benefits deriving from the allocation of public resources to foreign investors through investment incentives.

2.3.1 Some specific findings on the use of tax incentives to attract FDI: does the level of development matter?.

Thomas (2007) in his work on investment incentives indicates that investment incentives were not a marginal or geographically-limited phenomenon and that on every continent, multiple levels of governments use location subsidies to try and promote investment. He is also of the opinion that investment incentives were mainly the tool of *industrialised countries*, though increasingly developing countries have recently adopted incentives in an attempt to counter their use by the developed countries. Following below are some of the country specific cases, borrowed from Thomas' work, which reviewed the issue of offering investment incentives.

In the case of the US, Thomas (2007) found that the U.S. federal government allowed for accelerated depreciation, which is considered as an incentive offered to attract investment into the United States rather than other countries where widely available accelerated depreciation is not the norm. Accelerated depreciation for machinery and equipment was estimated to have cost the U.S. Treasury US\$ 44.7 billion in Fiscal Year 2004 (GAO, 2005 as cited in Thomas, 2007). Jensen and Malesky (2010) remarked that despite broad skepticism about the benefits of globalisation, the majority of U.S. states had offered lucrative tax incentives to attract investment. They indicate that the size of these incentives was generally considered too large to be welfare enhancing, and that many economists were skeptical of the effectiveness of those policies. Yet despite the mounting evidence to the contrary, the

incentives offered by the U.S. have continued and have actually increased in their generosity over time. This shows that even the US has been extending tax incentives to attract investment, and that foreign investment is important regardless of the level of development.

In Canada, Thomas (2007) found that the incentives game was being played at the provincial level and that they were much more highly centralised than in the United States. For large incentives, such as those in the automobile industry, he indicated that there was often federal as well as provincial participation in the awarding of subsidies.

In terms of *fast developing countries*, Thomas found that China was attracting substantial investment with its low labour costs and large number of skilled workers. This, he explains, was in addition to providing a full five-year tax holiday and another five years with 50 percent tax liability, while cities and regions also gave incentives to investors. In the case of India, he is of the view that the country's 2005 Export Processing Zone (EPZ) legislation led to the approval of 200 EPZ businesses by March 2007, while tax breaks, labour law and regulatory concessions had been the main drawback (Thomas, 2007).

South Africa's investment incentives were found to have included a 30 percent grant for so-called Critical Infrastructure, a 15 percent foreign investment grant and a free trade zone program (Country Finance Select, 2006 as cited in Thomas, 2007). The study revealed that the South African Government introduced location subsidies in March 2007 for call centres of up to approximately US\$8,570 per seat, with a total of US\$154 million having been budgeted through March 2011. Thomas indicated that the Motor Industry Development Program of South Africa further provided substantial benefits to the industry, including a 20 percent investment grant.

Efforts have been made to measure the effectiveness of FDI incentives in many other countries of the *developing world*. Three examples, namely the studies done on Egypt, the Carribean and Namibia are summarised below.

In his work on the effectiveness of tax incentives in Egypt, Massoud (2003) concluded that the policy on FDI in Egypt should have focused on deriving macroeconomic benefits from FDI rather than on attracting the FDI. The study stated that offering incentives, especially tax incentives, was not the way out to more benefits, but improving the availability of sufficiently qualified labour, focusing on the establishment of sound institutions, and opening up to international trade would make Egypt's locational characteristics more favourable to potential investors.

Research work on the Carribean countries that makes up the Eastern Carribean Currency Union (ECCU) include that by Bain in 1995 (as cited in Van Parys & James, 2010) which estimated revenue loss from tax concessions in the ECCU to have been between 23.5 percent in Anguilla to 53.9 percent in Grenada. A later study by Goyal and Chai (2008) measured both how beneficial tax incentives were for the cost of capital as well as how costly they were in terms of forgone revenue. They calculated revenue losses of between 9½ and 16 percent of GDP, implying that on average the ECCU countries would gain revenues as big as 9 percent of GDP if tax concessions were removed. This puts to doubt the extent of the benefits of extending tax incentives to the host country, the Carribean countries in this case.

For Namibia, Akinkugbe did some work in 2006 on measuring the benefits and costs of FDI in Namibia. Though he was unable to “matter-of factly” prove many of the costs associated with FDI in Namibia (as he put it), given data and other limitations; he could reveal some positive effects and some costs by employing a single equation approach, using available macro and micro data as well as a simplistic

cost-benefit analysis technique. The main conclusion of his work was that FDI is supposed to act as a supplement to domestic investment and not as a substitute; that the economic benefits of FDI are real and in most cases outweigh the costs; but they do not accrue automatically.

From the above literature review it is clear that countries around the globe have engaged the process of attracting FDI through various means and instruments, including tax incentives. However, it has been doubtful in most cases if the provision of investment incentives were backed up by any quantifiable evidence as Lall and Narula (2009) write: “it is nowadays well accepted that both economic growth and development are highly dependent on improving not just the availability of capital, but also access to technological capabilities, infrastructure and resources. This has gone hand-in-hand with an increasing economic liberalisation of most developing countries. The role of the MNE as a viable source of both capital and technology is one of the key features of this new openness. In the process of embracing FDI as a solution to the myriad of economic ills - something even the World Bank has begun to do - little attempt is made to understand the rationale and the costs associated with this policy stance. Simply put, FDI is not a condition *sine qua non* for development. Too much emphasis has been placed on attracting FDI, and not on understanding how to optimise the benefits for the host economy”.

2.4 Chapter Summary

The literature review has revealed that while FDI is generally agreed to as important for every economy, offering foreign investors investment incentives (and tax incentives in particular) for the purpose of attracting FDI has been a debatable issue; and as such literature in that field is far from being conclusive. Some studies have argued for the provision of tax incentives to attract FDI, arguing that they will

induce foreign investment in a country and that governments should provide such incentives. Others have argued against it citing that the costs that country incurs could be much greater than the benefits they derive from providing tax incentives to foreign investors. Literature also pointed to the fact that in most cases, the exact extent of benefits and costs have not been quantified, while the results from the few studies that tried to measure such yielded different outcomes.

Some early econometric studies concluded that tax policy was one of the key factors in the decision-making process of multinational enterprises, but not a decisive one, while some others considered fiscal incentives to be a weak stimulant but that they can act as a supplement to an already enabling and attractive environment for investment. Another important view from literature is that foreign investors, who are the primary target of most tax incentives, base their decisions to enter a country on a whole host of other factors, including natural resources, political stability, transparent regulatory system, infrastructure, and skilled workforce. This study will attempt to establish what the experience of Namibia with regard to the above issues has been.

3. Overview of the Investment Incentives Framework of Namibia¹

3.1 Introduction

In order to contextualise the discussions and findings of this study, the researcher deemed it necessary to provide an overview of the existing investment incentives regime of Namibia and what the trend of FDI inflows to Namibia has been is outlined below.

In an attempt to boost the flow of foreign investment to the country, Namibia enacted the *Foreign Investment Act of 1990* after attaining independence in 1990. The Act has been administered by the Ministry of Trade and Industry (MTI). The Foreign Investment Act is the primary legislation that governs FDI in the country.

Under the framework of the Foreign Investment Act, the Ministry of Trade and Industry established the *Namibia Investment Center (NIC)*, which serves as the official investment promotion agency of the Namibian Government. The information on the official website² of the Ministry has explained the following as being the mandate of the NIC. The services offered by the NIC are comprehensive, ranging from the initial inquiry stage by potential investors to operational stages. It thus provides general information and advice on investment opportunities, various incentives offered by the Government and procedures to follow when wanting to invest in Namibia. The NIC also plays a coordinating role with other government ministries and agencies so as to reduce bureaucratic red tape for investors. Other functions of the NIC include screening of all potential foreign investments, evaluating

¹ The source for the information on Namibia's tax incentives is the Ministry of Trade and Industry, in particular the Investment Centre.

² Accessed at www.mti.gov.na.

the credibility of potential investors and potential economic benefit to the country, on the basis of which recommendations are made to the Minister of Trade and Industry regarding the proposed investments. In recognition of the importance of enlarging the manufacturing sector base and the need to boost the country's export capacity, the Namibian Government has also put in place various investment incentives as well as special tax incentives for the manufacturing sector. These are outlined below.

3.2 Types of Investment Incentives Offered by Namibia

The following are incentive schemes that have been used by Namibia to attract foreign direct investment³. There are both tax and non-tax incentives applicable to existing and new manufacturing enterprises after having registered as manufacturers. The tax-based incentives, which entail tax relief to eligible investors and exporters of manufactured goods, include the following:

- a reduced corporate tax rate of 18% compared to a normal rate of 34%;
- exemption on purchase and import of manufacturing equipment and machinery;
- a special building allowance, which permits factory buildings to be written off at 20% in the first year and the balance at 8% for 10 years;
- a transport allowance, which writes off 25% of land-based transportation costs;
- an export promotion allowance, which permits an additional deduction of 25% from taxable income; and
- a training deduction of up to 125% of training costs related to manufacturing activity.

³ The information has been obtained from the Ministry of Trade and Industry's Investment Centre (the NIC).

Non-tax based incentives such as financial assistance for industrial studies and export promotion activities are also available to registered manufacturers. In terms of export promotion incentives, manufacturers can apply for grants of up to 50% of the direct costs of approved export promotion activities.

The Government of the Republic of Namibia also established an *Export Processing Zone (EPZ)* under the framework of the EPZ Act (Act 9 of 1995) in order to boost the export industry. Administered by the Offshore Development Company (ODC), the EPZ regime effectively got off the ground in 1996, after the enactment of the Act, and has been a policy instrument that has formed part of the overall industrial and export development strategy of Namibia. As such, companies with EPZ status can set up their operations anywhere in Namibia, without any restrictions on the industrial sector. The only requirement is that exports should be destined for markets outside the Southern African Customs Union (SACU)⁴ and earn foreign exchange for the benefit of the Namibian economy. Typically, firms in the EPZ regime are exempt from paying import duties and VAT on machinery, equipment and raw material imports for manufacturing purposes. They are also exempt from paying corporate income tax. Non-resident shareholders are however liable for a 10% withholding tax on declared dividends.

We learnt from MTI that various companies from continents around the globe have been the source of investment in the EPZ, such as investors from Africa, Asia, Europe and North America that had been fully operational and making use of the EPZ incentives in Namibia. Overall, the EPZ regime in Namibia has contributed to the attraction of both domestic and especially foreign investment into the country (i.e. the

⁴ This is a Customs Union between four countries: South Africa, Namibian, Botswana, Lesotho and Swaziland.

majority of the EPZ companies have been foreign-owned, though some Namibian companies have also taken advantage of the generous incentives offered under the regime). However, the regime has had its fair share of setbacks. The criticism has been that the bulk of the EPZ companies involved in processing should in actual fact not have qualified for EPZ status as they have been using local raw materials and which defeats the intended objective of the EPZ regime. These are smaller firms involved in the manufacturing sector (mainly in mineral processing) which were attracted to the regime and acquired the EPZ status.

Other features of the Foreign Investment Act also include a provision that guarantees equal treatment for both foreign and local investors. In this regard, the guarantee ensures fair compensation for foreign investors in cases of expropriation, international arbitration of disputes between investors and the Government, the right to remit profits and access to foreign exchange. Furthermore, within the framework of the Common Monetary Area (CMA), Namibia has opened up the exchange control environment to make it easier for foreign investors to invest in the Namibian economy and be able to repatriate earnings, dividends and profits with ease. In particular, the following are some of the current exchange controls (as obtained from the Bank of Namibia), which have a bearing on foreign investors:

- Foreign investors are allowed to borrow in the domestic market without restrictions for financing of bona fide foreign direct investment operations in the country or for domestic working capital requirements. This excludes borrowing for financial transactions and/or to acquire residential property in Namibia.
- On presentation of audited financial statements and confirmation that tax obligations in Namibia have been met, foreign investors are also allowed to

repatriate their earnings and pay dividends to shareholders abroad without restrictions.

- Foreign investors may raise third party loans offshore on condition that such loans attract an interest rate not exceeding the Libor lending rate plus a margin of 2%.
- However, investors wishing to borrow from their parent company abroad are subjected to a thin capitalisation ratio of 3:1 of shareholders loan to share capital. The share capital being the portion of own funds introduced into the equity of the local subsidiary.
- All exports of commodities manufactured in Namibia must result in accrual of foreign currency proceeds to Namibia within a period of 90-days from the date of exports.

EPZ companies are exempt from the aforesaid requirements, as they are essentially allowed to conduct their operations in Namibia free of exchange control obligations.

Other benefits in the form of grants, loans, land and infrastructure have also been offered by the Government of the Republic of Namibia, especially for major investment projects. For example, the Government has provided grants to EPZ companies for training programs to improve the skills and productivity of Namibian workers.

There are other important laws such as the 2004 Companies Act that came into force in November 2010 and the 1998 Close Corporation Act. These are also an integral part of the investment framework in Namibia as they provide the legal framework for establishing business entities in the country.

Although Namibia has had mixed results with attracting major industries to establish themselves in the country, her investment laws and policies have generally

been hailed as having provided a conducive investment environment. A review by the Namibian Tax Consortium in 2002 concluded that the generous EPZ provisions have been reasonably successful, though the cost in terms of revenue forgone needed to be monitored (The Namibian Tax Consortium Report, 2002). The positive view is also evidenced by the confirmation by independent rating agencies through their ratings of Namibia's investment climate over the years. For example, in its *2011 Doing Business Report*, the World Bank ranked Namibia in the 69th position among 183 countries. This however represented a steady decline in rankings since 2007, when it was ranked 42nd among the 175 countries that were evaluated.

According to the 2011 report, lowest rankings were achieved for trading across borders, registering property and starting a business. The report indicated that Namibia requires on average 10 procedures and 66 days to start a business. It further stated that registering a property takes on average 9 procedures and 23 days, and the process costs nearly 10% of the property's value. The report further revealed that it takes 11 documents and approximately 29 days to export a product and 24 days to import an item (trade across borders) in Namibia. In December 2010, the Fitch Ratings service's assigned Namibia a long term foreign currency rating of BBB-, which was consistent with the 2009 rating.

In 2005, however, an Investor Roadmap Study for Namibia conducted by the Southern Africa Global Competitiveness Hub (or Trade Hub) identified weaknesses and made recommendations in the areas of administration, regulation and procedures which Namibia had to improve on so as to enhance her attractiveness to foreign direct investment (FDI). Trade Hub engaged a follow-up audit of the implementation of its earlier recommendations in 2010, which determined that only 16 recommendations had been implemented at the time, while 24 others were still pending.

The provision of investment incentives by Government, especially those provided to attract foreign investors, has generally also faced criticism. The question has been whether the provision of tax incentives has benefitted the country and or whether foreign investors have benefitted more from tax incentives at the expense of the local economy. The Institute for Public Policy Research (IPPR), for instance, through its analysis of the 2003 budget pointed out that revenue from non-mining corporate tax had been declining in real terms which could be ascribed to the tax incentive regime (IPPR, 2003). The Foreign Investment Advisory Service (FIAS)'s report of December 2006 confirmed this criticism when it concluded that the tax-based incentives were not being a catalyst for start-up of new firms and/or facilitating existing business to undertake additional investment in new technologies. According to the FIAS, these problems arose mainly because tax burdens were not the primary obstacle to investment in Namibia. FIAS highlighted the following as having been some of the bigger obstacles to investment in Namibia:

- the shortage of skilled labour;
- the uncertainty about protection of property rights;
- the uncertainty around the interpretation of the qualification criteria, a discretionary approach to their implementation, a lack of coordination across different ministries, and administrative hitches.

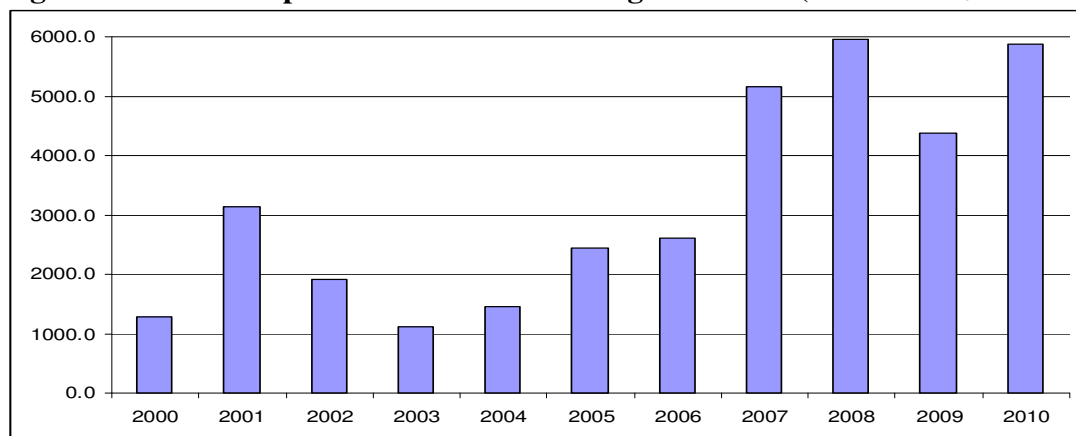
As such, FIAS was of the view that not a lack of financial and other incentives, but weak and ineffective institutional structures in Namibia were instrumental in impeding Namibia's investment and export success. This suggested the need to strengthen the legal framework and institutional structures so as to improve the country's efforts to achieve meaningful and beneficial FDI attraction. The Ministry of Trade and Industry is in the process of reviewing the current investment framework to

also cater for domestic investment. There is also an intention to expand incentives beyond the manufacturing sector to other selected industries such as the hospitality and tourism industries. It is expected that Government will improve on the current investment incentive scheme, based on the lessons learnt from the current scheme and come up with an efficient and effective incentive scheme.

3.3 FDI Inflow to Namibia versus the Region and World

After attaining its independence in 1990, Namibia opened its borders to FDI through the introduction of the investment framework outlined above. Chart 1 below depicts the trend of FDI inflows to Namibia for the last decade.

Figure 1. FDI developments in Namibia during 2000-2010 (values in N\$ millions)



Sources: Bank of Namibia

As can be seen from the Chart above, Namibia managed to attract reasonable FDI during the past decade. In fact, FDI inflows have been increasing steadily over the depicted period, with the exception of years 2002-2003 and 2009 where FDI inflows declined. This trend was evident in the previous decade, with significant inflows coming in especially since 1997. The increase in FDI flows moved from an average of 13% in the 90s to an average of 32.1% during the period 2000-2005 and to an average of 25.4% during 2006-2010 when a peak of 97.3% was reached in 2007.

For comparison purpose, and to get a sense of how Namibia has fared against other African countries in terms of FDI attraction, more especially other Southern African countries, Table 1 is presented below. The table outlines inflows of FDI to Africa and in particular to Southern Africa, but also to the world in general. Namibia has been amongst the top four Southern African countries in terms of attracting FDI. During the period 2005-2010, the country recorded an average share of 1.1% of the total FDI inflows to Africa after the top three performers Angola, South Africa and Zambia (in that order) with averages of 18.8%, 8.6% and 1.4%, respectively. Namibia's share of the total inflows to the sub-region (Southern African) was much higher, increasing from a low of 2.4% in the year 2005 to 5.7% in 2010, although this has again been below those for Angola, South Africa and Zambia. This could be an indication that Namibia's effort at attracting FDI has paid off.

Table 1
Namibia's share in total FDI inflows to the continent and region during 2005-2010 (millions US\$ and percentages)

	2005	2006	2007	2008	2009	2010	
WORLD	982593	1461863	1970940	1744101	1185030	1243671	
AFRICA	38160	46259	63132	73413	60167	55040	
SOUTHERN AFRICA	14699	10501	18764	28588	19999	15105	
Angola	6794	9064	9796	16581	11672	9942	
Botswana	279	486	495	528	579	529	
Lesotho	57	89	97	56	48	55	
Malawi	52	72	92	9	60	140	
Mozambique	108	154	427	592	893	789	
Namibia	348	387	733	720	516	858	
South Africa	6647	527	5695	9006	5365	1553	
Swaziland	46	121	37	106	66	93	
Zambia	357	616	1324	939	695	1041	
Zimbabwe	103	40	69	52	105	105	
% SHARE IN AFRICA							<i>Average</i>
Angola	17.8	19.6	15.5	22.6	19.4	18.1	<i>18.8</i>
Botswana	0.7	1.1	0.8	0.7	1.0	1.0	<i>0.9</i>
Lesotho	0.1	0.2	0.2	0.1	0.1	0.1	<i>0.1</i>
Malawi	0.1	0.2	0.1	0.0	0.1	0.3	<i>0.1</i>
Mozambique	0.3	0.3	0.7	0.8	1.5	1.4	<i>0.8</i>

Namibia	0.9	0.8	1.2	1.0	0.9	1.6	1.1
South Africa	17.4	1.1	9.0	12.3	8.9	2.8	8.6
Swaziland	0.1	0.3	0.1	0.1	0.1	0.2	0.1
Zambia	0.9	1.3	2.1	1.3	1.2	1.9	1.4
Zimbabwe	0.3	0.1	0.1	0.1	0.2	0.2	0.2
% SHARE IN SOUTHERN AFRICA							
Angola	46.2	86.3	52.2	58.0	58.4	65.8	61.2
Botswana	1.9	4.6	2.6	1.8	2.9	3.5	2.9
Lesotho	0.4	0.8	0.5	0.2	0.2	0.4	0.4
Malawi	0.4	0.7	0.5	0.0	0.3	0.9	0.5
Mozambique	0.7	1.5	2.3	2.1	4.5	5.2	2.7
Namibia	2.4	3.7	3.9	2.5	2.6	5.7	3.5
South Africa	45.2	5.0	30.4	31.5	26.8	10.3	24.9
Swaziland	0.3	1.2	0.2	0.4	0.3	0.6	0.5
Zambia	2.4	5.9	7.1	3.3	3.5	6.9	4.8
Zimbabwe	0.7	0.4	0.4	0.2	0.5	0.7	0.5

Source: World Investment Report 2011, UNCTAD and own calculations for percentage shares

The question that arises from the picture depicted in the Table above is whether or not the different (tax) incentives provided by different countries of the Southern African region have led to the outcome depicted in the Table, i.e. have those that attracted more FDI offered better incentives than those that have attracted relatively lower FDI or have other factors perhaps been responsible for the situation?

A study conducted in 2004 by the Nathan-MSI Group on the effectiveness and economic impact of tax incentives in the SADC region (of which all countries presented in the Table are members together with some other countries), indicated that all SADC countries had been offering generous tax incentives. Drawing on the international and regional experiences, the study made the following two conclusions amongst others: that non-tax factors are far more important than tax incentives in determining the level and quality of investment flows and that investment incentives work well in some countries and poorly in others as the effectiveness and impact of any package of incentives depends on local economic and fiscal conditions, characteristics of the incoming investment projects and political judgments about

trade-offs among competing policy objectives. As such, no straight answer can explain the situation depicted in Table 1 above, as a whole lot of factors could have been at play, and that makes comparison on the basis of only tax incentives difficult. There are however certain cases, which could clearly be ascribed to certain tax incentives offered by specific countries in the SADC sub-region. For example, the case of the Ramatex textile factory which settled in Namibia in 2002 was a case of intra-regional tax competition in which Namibia emerged a winner. There has been a general agreement also that tax incentives took the Mozal aluminium smelter to Mozambique. Other cases could not clearly be linked to only tax incentives.

What this study attempts to do therefore is to analyse what the Namibian situation has been with regard to attracting FDI, i.e. whether FDI came to Namibia because of the tax incentives offered, to what extent the country benefitted from such investment inflows and at what expense were the incentives offered. These are the subject matters of the next chapters which attempts to analyse and estimate certain aspects that will shed more light to the issue.

3.4 Chapter Summary

The above has shown that Namibia has a clear and targeted legal investment framework. The existence of an Investment Centre also creates an environment to provide dedicated attention and assistance to foreign investors. This complemented by the investment incentives offered and the existence of an Export Processing Zone (EPZ) renders the country to be in a position to attract foreign investment. In fact, the country has managed to attract some FDI inflows as evidenced by the statistics provided in section 3.3 above. In the words of the Ministry of Trade and Industry: “the country offers among the most attractive fiscal incentives in Africa via its Export Processing Zone regime”. The special tax incentives for manufacturers introduced in

1993 seem to have assisted the country in attracting investment to that sector as well, as evidenced by the winning of a competitive war to have the Ramatex textile factory invest in Namibia in 2002, though it closed down a few years later. The investment regime has however faced criticism in that its focus has been more on foreign investors, neglecting local investors. It is also not clear whether the foreign investment that came to Namibia can entirely be attributed to the provision of investment incentives and/or whether or not the incentives so provided have been efficient, i.e. how do the benefits derived from offering tax incentives compare to the costs the country has incurred in offering them? It is important to determine what are the exact factors that brought foreign investment to Namibia to ensure that the current foreign investment policy is effective and efficient, a task that this study is attempting to embark on in the ensuing chapters.

3.5 Theoretical Framework

The review of literature (both theoretical and empirical) discussed above indicates mixed views regarding the effectiveness of investment incentives, in particular tax incentives as a tool to attract FDI. Arguments both in favour and against the use of tax incentives have been advanced as explained in section 2.4 above. Those in favour have argued that incentives will induce foreign investment and thus government should provide them. Those against incentives have argued that they cause distortions in that investment decisions are made that would not have been made without the inducement of special tax concessions, while they can also be both ineffective and inefficient, i.e. ineffective in that tax considerations are only rarely a major determinant in FDI decisions; while they are inefficient because their cost, in terms of tax revenue foregone, often far exceeds any benefits they may produce. Literature on FDI incentives has also indicated that the effectiveness of incentives

differs among types of investors or investments. It follows that location choices (as postulates by the OLI theory under chapter 2) for export-oriented FDI are more likely to be affected by tax incentives than are those for foreign direct investments meant primarily to serve local domestic markets.

A further argument is that an export-oriented FDI might be more concerned with the cost structure of production in its investment location than with market-seeking and natural resource-seeking FDI. Early studies concluded that tax policy was one of the key factors in the decision-making process of Multinational Enterprises, but not a decisive one, while fiscal incentives were also considered to be a weak stimulant. In general, most econometric studies have found that the different FDI incentives, whether tax incentives, financial subsidies or regulatory exemptions directed at attracting foreign investors can not be substituted for pursuing the appropriate general policy measures and focusing on the broader objective of encouraging investment regardless of source. Nevertheless, incentives can act as a supplement to an already enabling and attractive environment for investment.

Moreover, foreign investors, which are the primary target of most tax incentives, base their decision to enter a country on a whole host of other factors, such as natural resources, political stability, transparent regulatory system, infrastructure, and skilled workforce.

The section on Namibia's investment incentives regime and the trend in FDI inflows showed that Namibia has managed to attract some FDI but it is not clear whether that has been a result of the tax incentives offered or perhaps that other factors could have led to that. The next section of this study therefore attempts to answer this question, taking into consideration the above views from the theoretical and empirical literature.

4. Methodology

4.1 Introduction

As alluded to earlier in chapter three, tax-based incentives in Namibia aim to promote the manufacturing sector, and thus entail tax relief to eligible investors and exporters of manufactured goods. They include reduced corporate tax rate (18%), exemption on purchase and import of manufacturing equipment and machinery, a special building allowance for writing-off factory buildings at 20% in the first year and the balance at 8% for 10 years, a transport allowance to write-off 25% of land-based transportation costs, an export promotion allowance in the form of an additional deduction of 25% from taxable income; and a training deduction of up to 125% of training costs related to manufacturing activity. The analysis of this study focuses mainly on the corporate tax rate, i.e. what the impact of a reduced corporate tax rate has been on foreign investment. Other incentives may also be alluded to in the process, while other factors considered to be important for attracting foreign direct investment will also be discussed.

4.2 Explaining the methodology

This study poses a general question of whether or not FDI inflows to Namibia have increased due to the tax incentives (i.e. the reduced corporate tax rate) offered to foreign investors; and hence whether or not offering such incentives has been beneficial to the country. To answer this question and given the unavailability of data that limits the use of other more effective and robust methodologies such as the elasticity approach employed by Hines in 2000 (as quoted by Massoud, 2003) on America and adopted by Massoud in assessing the effect of incentives on the incremental increase in FDI in Egypt, the study chose to follow two methods, namely

the analytical approach used by Stapper (2010) in his work on tax regimes in emerging Africa with specific emphasis on whether corporate tax rates boost FDI in sub-Saharan Africa, complemented by a Chi-square test which is a non-parametric statistical test used to test the true value of parameters, especially in a situation where it is possible to express a relationship within or between data items as a statistical model with parameters to be estimated from a sample. The two methods are elaborated on below.

The Pearson's correlation coefficient (denoted by letter 'r' in the formula below) is a statistical measure of the strength of a linear relationship between two variables. In other words, the correlation between variables measures how well the variables are related, i.e. it measures for example, what happens to one variable in a pair as the other variable increases or decreases. The Pearson correlation can be represented by the following formula⁵:

$$r = \frac{n(\sum xy) - (\sum x)(\sum y)}{\sqrt{[n\sum x^2 - (\sum x)^2][n\sum y^2 - (\sum y)^2]}}$$

By design, the method is constrained as follows:

$$-1 \leq r \leq 1$$

The above formula shows that results of Pearson's correlation need to be between -1 and 1. A result of -1 will indicate a perfect negative correlation between the two values, or using the example in the above paragraph, it will mean that the two

⁵ Reproduced from <http://www.statisticshowto.com/articles/what-is-the-pearson-correlation-coefficient>.

variables tend to move in different directions (i.e. one variable tends to decrease/increase as the other one increases/decreases). In contrast, a result of 1 gives an indication of a perfect positive correlation between the two variables, and using the same example as above, it will mean that the two variables tend to move in the same direction (i.e. one variable tends to increase/decrease as the other one decreases/increases). Getting an outcome of 0 will mean that there is no correlation between the two variables or that no linear relationship between the two variables exists (i.e. the other variable depicts no tendency to either increase or decrease).

Using Pearson's correlation coefficient⁶, Stapper (2010) analysed the correlation of FDI to (corporate) tax rates as well as the impact of other relevant factors for various sub-Saharan African economies and concluded that the height of the corporate tax rate does not affect foreign investors and that a comprehensive policy is needed.

The correlation test explained above will be complemented by a chi-square test to assess the prediction significance of each of the predictors as a means of verification. A chi-square test is one of the most widely used probability distributions in inferential statistics, for example, in hypothesis testing or in the construction of confidence intervals. As indicated earlier, it is used to determine if there is a relationship between two categorical variables. As such our test will involve hypothesis testing, i.e. testing whether the observed outcomes will differ from the hypothesised or expected outcome or not. Specifically, this study will employ the Wald chi-square test, through the E-views software, to evaluate the statistical significance of the coefficients of the predictors (i.e. whether any effect exists or not), using the below formula⁷.

⁶ This calculates a linear dependence between variables.

⁷ Accessed at http://www.saedsayad.com/logistic_regression.htm.

$$W_j = \frac{b_j}{SE_{b_j}}$$

Where W in the formula denotes the Wald's statistic, b stands for the coefficient and SE is the standard error.

Using the above two methodologies, the study explores the impact of the corporate tax rate on FDI in Namibia, in recognition that Namibia has been offering a special/reduced corporate tax rate to attract FDI in the manufacturing sector, i.e. 18% compared to the normal rate of 34%. In this regard, the study analyses total FDI flow into Namibia and its pace of growth during the period of existence of especially the special tax incentives for manufacturing after its introduction in 1993. As alluded to earlier, there has not been a change in the corporate tax rate offered for foreign investment since its introduction and this poses a limitation in the analyses. In a scenario of change in the corporate tax rate, it would have been more ideal to investigate how such change would have affected FDI flows into the country. This would have provided more insight in terms of what the reaction of foreign investors to changes in corporate tax rate would have been. Nevertheless the outcome of this limited analysis should provide an idea of what transpired in Namibia on that front. In addition to total FDI inflows, the study also investigates the trend in the components of FDI to determine which form of FDI between equity and retained earnings has reacted more to the tax incentives.

In an attempt to confirm the argument by literature that factors other than corporate tax rate could also play a role in the attraction of FDI flows to a country, other selected factors which are considered important in terms of attracting foreign investment are also investigated to determine to what extent they might have influenced the attraction of FDI inflows to Namibia. These are factors such as the

share of natural resources into the country's total exports, the extent to which investors trust the Namibian economy, the availability of good infrastructure, the labour market conditions (i.e. whether flexible or rigid) and the functioning of Government. The rationale for selecting each of the factors and the approach of estimation will also be explained. The investigation involves running some correlations using the Pearson's correlation coefficient and chi-square methods (through the E-views software as explained above) to calculate the relations of these additional variables that will shed more light to the experience of Namibia in attracting FDI. The rationale of running these specific correlations will also be explained.

To complete the picture after having determined the magnitude of FDI that came to Namibia and the derived benefits for the economy, the study attempts to assess the cost involved, i.e. what did it cost Namibia to attract such investment, and at what cost have the benefits been extended. This is because literature has indicated that providing tax incentives can be costly to the host country, both directly and indirectly. Thus the cost of the incentives, possibly including that to the budget will be estimated and analysed where possible. This will enable us to draw a conclusion on the exact effect of Namibia's existing tax policy for promoting investment.

The most prominent cost concerns the aspect of revenue loss for the host government, which results from various factors including redundancy and what is termed 'reverse foreign aid'. Redunancy occurs when exemptions are provided for investments which would have come even in the absence of incentives. According to Wells et al. (2001) as quoted by Massoud (2003), if tax incentives are given only to investors who would not otherwise have allocated their investments in the host country, and are exactly the amount required to attract them, then there is no revenue

loss from the incentives and thus zero redundancy. On the other hand, if incentives go to investors who would have invested in the country even in the absence of the incentives, then there is redundancy and the foregone revenue from those redundant incentives represents a cost to the treasury. That cost therefore, as per their explanation, is equivalent to a subsidy to attract the incremental investors.

Literature has acknowledged that quantifying the exact cost to the fiscus is challenging, as it involves determining the redundancy rate⁸ which is not easy to calculate because it is not easy to separate the investment projects that would have come anyway from those that would not have come. The redundancy rate is a key variable in the formula for computing the extent of redundancy (and hence the cost of fiscal incentives) suggested by literature as illustrated below.

$$\text{Unnecessary tax exemption} = R \times I \times Y \times N$$

where,

t = the tax rate,

Y = the investor's average return, based on the rate of return on equity (ROE)

R = is the redundancy rate (the fraction of investors who would have come without incentives),

N = is the number of years of tax holiday (or an incentive is being extended),

and

I = is the total foreign investment.

Massoud (2003) implemented this formula in the case of Egypt to estimate the fiscal cost of incentives to that country and found that attracting FDI has not been

⁸ The percentage of investors receiving tax incentives that would have invested in the country even if they had not been granted incentives, or the level at which tax incentives were offered unnecessarily by Namibia and hence the level of cost of fiscal incentives to the country.

costless on the national budgetary side of that country. This study also applies the aspect of redundancy in an attempt to get an indication of the cost of tax incentives to the Namibian Government, though through a different methodology given the unavailability of data on the redundancy rate and investors' average return which are key components in the calculation of redundant incentives in the formula presented above.

The data sources for the analysis of this study pertaining to the above variables and indicators are mostly secondary, comprising of the administrative records of data collecting agencies in Namibia, namely the National Statistics Agency (NSA) and the Bank of Namibia (BoN), various international reports such as the various Doing Business Reports (1994-2012) of the World Bank, and the World Competitive Report. An attempt has also been made to administer a survey to relevant foreign investors (see Appendix) but yielded a very poor⁹ response rate. We have however still cautiously looked at the responses to give us some indication as will be mentioned in subsequent sections.

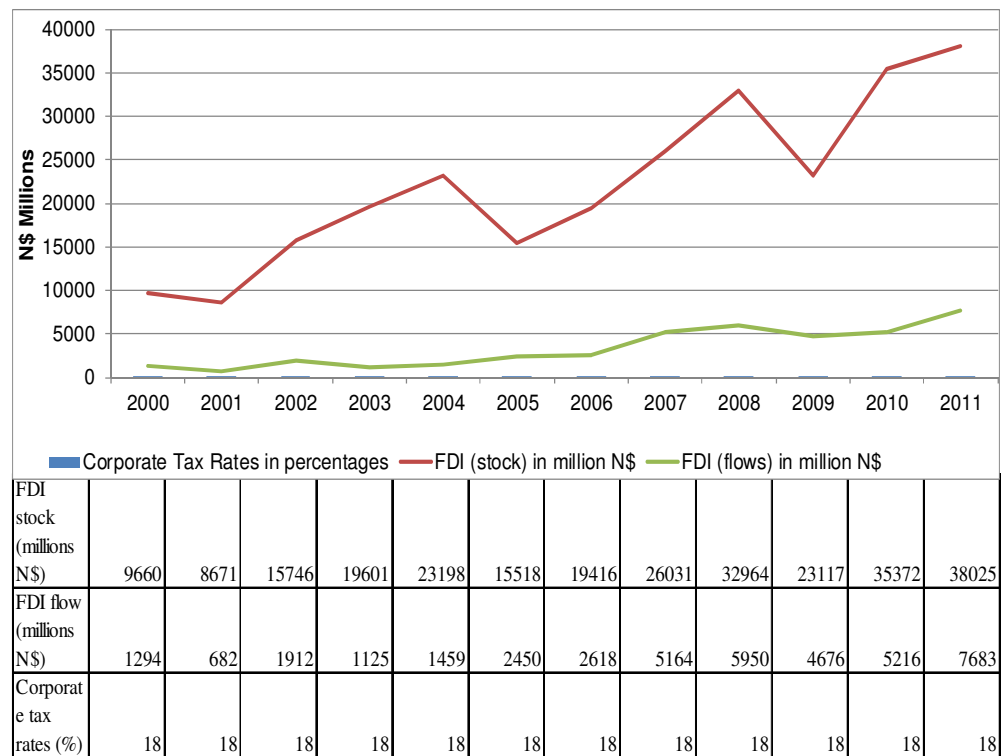
⁹ Only 12% of the 25 companies approached responded.

5. Determining the Impact of Tax Incentives on FDI in Namibia

5.1 The Impact of Corporate Tax Rate on FDI Flows in Namibia

Namibia offers a reduced corporate tax rate of 18% to foreign investors (especially in the manufacturing sector) compared to a 34% had there not been any exemptions. Following below is an investigation and analysis of trends in foreign direct investment that came to Namibia at the reduced corporate tax rates offered to foreign investors during 2000-2011. This is an attempt to determine how FDI inflows reacted to developments in corporate tax rates over that period.

As indicated under section 3.2 above, and as can be seen from Chart 2 below, Namibia did manage to attract reasonable foreign direct investment. FDI inflows have been increasing steadily over most of the years of the last decade, with the exception of years 2001 and 2003 and 2009 where FDI inflows declined. An average increase in FDI flows of 32.1% was registered during the period 2000-2005, though the pace of growth reduced to an average of 25.4% during 2006-2010. A pick of 97.3% in flows was reached in 2007.

Figure 2. Trend in FDI inflows and special corporate tax rates (2000-2011)

Source: Bank of Namibia and Ministry of Finance for the corporate tax rate.

It is not exactly clear, however, whether the FDI inflow was due to the tax incentives offered or to other factors, given that the status has remained the same since the reduced corporate tax was first introduced in 1993. A scenario where some changes occurred in the tax incentives offered (i.e. the reduced corporate tax rate) over the period would have been a good indication as it would have been possible to see how FDI inflows would have reacted in that scenario and make a concrete conclusion.

Table 2 below presents the FDI composition in Namibia for the pervious decade and shows the developements of the components over the year 2000-2010. We thought to look at this so as to determine what form FDI in Namibia has taken.

Table 2 Namibia's FDI composition trends (millions of N\$)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Total	1293.6	3143.8	1911.7	1125.2	1458.9	2449.9	2617.7	5164.4	5950.3	4375.8	5865.5
Equity capital	607.3	3021.0	1425.0	842.4	838.8	1412.0	2948.1	3952.3	2622.9	274.7	66.0
Reinvested earnings	745.1	909.7	151.3	-545.7	490.9	1288.2	1019.0	1318.2	1114.8	1327.0	3555.4
Other capital	-58.8	-786.9	335.4	828.5	129.1	-250.4	-	-106.1	2212.6	2774.2	2244.1
Liabilities to direct investors	13.9	-656.0	44.2	160.6	129.6	-239.4	244.1	-468.2	2217.8	2722.6	2012.2
Claims on direct investors	-72.7	-130.9	291.1	668.0	-0.5	-11.0	-	362.1	-5.2	51.6	231.9

Source: Bank of Namibia

It is clear from the Table that equity capital has been generally increasing during the period under review, though the trend reversed during the last three years of the period when it indicated declines. The same increasing trend is generally true for the reinvested earnings component of investment; in fact it has been a stronger source of FDI in the recent years. This could be a sign of investor confidence in the Namibian economy. The confidence is evidenced particularly in recent significant investments, mainly in the mining sector but also in the manufacturing sector.

A closer look at data from the Bank of Namibia showed notable significant projects to have been the construction of the Ohorongo Cement Factory to the tune of N\$2.5 billion and which represents over 50% of total FDI inflows in 2009 as well as the 34% stake acquired by Portugal Telecom in the state-owned mobile telecommunications company, MTC in 2006. In 2010, investments in the manufacturing and construction sectors totalled approximately N\$1.5 billion and

N\$1.7 billion, respectively, with reinvested earnings and borrowing by Namibian companies from foreign parent companies¹⁰ being the main source of FDI.

Other significant forms of investment activities have also been engaged by foreigners before this review period, such as joint ventures with Government in the mobile telecommunications and mining sectors. An equal shareholding partnership (50-50) between the Government of the Republic of Namibia and DeBeers formed the NAMDEB mining company in 1994.

5.2 Assessing the Impact of Other Factors Identified as Important for Attracting FDI

The literature reviewed has indicated that there can be many other factors (other than tax incentives) that influence the inflow of FDI to a country. It further alluded to the fact that investors will go to a country, if its market, climate and policies are attractive whether the country offers tax incentives or not (Wells et al, 2001). The small number of returns from the researcher's administered investor survey have confirmed this view, with political stability and certainty of investment policies having been cited amongst the factors that led them to invest in Namibia. As such, this section attempts to empirically investigate whether the identified factors¹¹ considered important for attracting foreign investment have had any impact in the case of Namibia. As mentioned earlier, these factors are the share of natural resources in total export, the level of investors' trust for the Namibian economy, availability of

¹⁰ This is the main sub-component of the category 'other capital' in Table 2.

¹¹ The factors have been selected from the many identified by literature. Selection has been based on what we considered relevant in the case of Namibia as will be seen from the explanation under each as to the rationale of looking at them.

necessary infrastructure, the functioning of the Namibian Government and the functioning of the labour (employment) market.

5.2.1 The share of natural resources in total export.

Literature pointed to the fact that countries which are highly dependent on natural resources for their exports also pose a high percentage of total foreign investment as percentage of GDP (for example, refer to Stapper, 2010). This implies that they have managed to attract foreign investment because of the fact that natural resources are often sought after by foreign investors. In the case of Africa, the importance of natural resources was also confirmed by a Report of the Working Group of the Capital Markets Consultative Group released by the IMF in 2003 based on a survey on foreign direct investment in emerging market countries, which revealed investors having shared their preference for the South African market indicating that their “investments outside South Africa were generally limited to the extractive and basic industry sectors, where the opportunities offered by natural resource availability (especially oil) offset the legal and institutional problems of operating in sub-Saharan Africa”.

Namibia has an abundance of natural resources¹², with primary industry exports having contributed on average just above 40% to its total exports during the period 2000 – 2011 (see Table 3 below). Ores and minerals constituted the bulk of the country’s total natural resource exports (about 88% on average) during the same period, and has in fact been the second biggest contributor to total exports (with 37.4%) after manufacturing (with 41.5%). In fact ores and minerals used to be the number one contributor in earlier years, while the manufacturing sector overtook it in

¹² Predominantly diamonds and uranium but also copper, lead, zinc, tin and silver.

later years, which could imply that the special investment incentives targeting the manufacturing sector have paid off.

Table 3
Total exports and selected export items (N\$ million and percentage contributions)

N\$ Millions	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	
Total Exports	11088	12574	16299	16185	16991	18678	24566	31496	38777	35511	38483	40644	
Exports (primary industry)	5717	6178	8071	5613	7178	7777	10928	13030	17351	12337	14408	15225	
Live animals, animal products & crop	344	421	805	716	733	926	1049	1118	1495	1070	1633	1596	
Fish&other fish products	188	190	253	158	156	185	218	425	240	230	162	308	
Ores&minerals	5185	5567	7013	4739	6289	6666	9661	11487	15616	11037	12613	13321	
Manufacturing exports	3496	4230	5378	7434	6730	8259	10027	14212	16941	17669	17473	18514	
% Contribution													Average
Exports (primary industry) to total exports	51.6	49.1	49.5	34.7	42.2	41.6	44.5	41.4	44.7	34.7	37.4	37.5	42.4
Live animals, animal products & crop to total primary industry exports	6.0	6.8	10.0	12.8	10.2	11.9	9.6	8.6	8.6	8.7	11.3	10.5	9.6
Fish&other fish products to total primary industry exports	3.3	3.1	3.1	2.8	2.2	2.4	2.0	3.3	1.4	1.9	1.1	2.0	2.4
Ores&minerals to total primary industry exports	90.7	90.1	86.9	84.4	87.6	85.7	88.4	88.2	90.0	89.5	87.5	87.5	88.0
Ores&minerals to total exports	46.8	44.3	43.0	29.3	37.0	35.7	39.3	36.5	40.3	31.1	32.8	32.8	37.4
Manufacturing exports to total exports	31.5	33.6	33.0	45.9	39.6	44.2	40.8	45.1	43.7	49.8	45.4	45.6	41.5

Source: Namibia Statistics Agency

To help us conclude whether Namibia's abundant natural resources have contributed to the attraction of foreign investment so far, the researcher ran a correlation (Pearson Correlation) between total FDI as percent of GDP and the share of natural resources in total export to determine the relationship between these two variables and found a positive correlation, though low (see Table 4 below). A look at the responses received from the foreign investors survey (though not representative, given the low response rate) did indicate that the availability of natural resources did play a more prominent role in their choosing to invest in Namibia (ranked at 9 on

average on a scale of 1-10¹³), rotating ranking places with political stability and tax incentives.

Table 4
Correlations between total foreign investment as a percentage of GDP¹⁴ and natural resources exports as percent of total exports

	Total Foreign Investment as % of GDP	Natural resources exports as % of total exports
Total Foreign Investment as % of GDP		
Pearson Correlation	1	0.27
Sig. (2-tailed)	11	0.82
N		11
Natural resources exports as % of total exports		
Pearson Correlation	0.27	1
Sig. (2-tailed)	0.82	11
N	11	

To complement and confirm the above findings, the study employed a Chi-square test to evaluate the statistical significance of the coefficients and hence the likelihood of the relationship; which also supported the findings. We tested the null hypothesis that the abundance of natural resources in Namibia has not been a prominent factor when investors were making decisions to invest in Namibia. In this regard, the slope coefficient was set equal to zero ($C(1)=0$) and the results are shown in Table 5 below. The probability value of 0.066 indicate that the null hypothesis is to be rejected at least at 10 percent significance level, and hence natural resources have been the driver of FDI inflow in Namibia.

Table 5
Results of chi-square test

¹³ The survey was administered to FDI investors (in the identified key FDI sectors), that came to Namibia since independence, to gather information on the factors that convinced them to invest in Namibia.

¹⁴ This is commonly used instead of absolute total foreign investment figures.

Test Statistics	Value	df	Probability
F-statistic	3.3892	(1,9)	0.103
Chi-square	3.3892	1	0.066

As another means of verifying the above findings, Table 6 below depicts some selected key sectors that have experienced reasonable FDI inflows in Namibia. For the period 1999-2007¹⁵, it is clear that apart from the financing, insurance, real estate and business services sector which is being treated as a special case¹⁶ by this study, the mining and quarrying sector stood in second place (or first place when considering the special treatment of the financing, insurance, real estate sector), having managed to attract, on average, about N\$8 127 million per year. This confirms the indications by the survey respondents that FDI to Namibia has mainly followed natural resources and not necessarily incentives. However, with the Government having been keen to reduce the country's dependency on primary industries and hence offering incentives to induce investment in the manufacturing sector, the country has experienced some local beneficiation in the mining sector in that a few diamond polishing factories have been established in the country. The manufacturing sector thus has come in at number four (or three, when taking the special treatment into account as indicated above) after the wholesale & retail trade, catering and accommodation services sector (as is evident in Table 5), and this could be an indication that the special incentives

¹⁵ Estimation for sectoral FDI has been discontinued by the source, i.e. Bank of Namibia.

¹⁶ While this depicts the highest average inflows in the Table, it mainly reflects the borrowing by Namibian companies from foreign parent companies, and which reflects some historical ties between Namibia and South Africa; and hence being considered a special case by this study.

dedicated to that sector might have been playing its intended role and hence the sector has managed to attract some FDI.

Table 6
Sectors which saw FDI inflows (1999-2007)

N\$ Million	1999	2000	2001	2002	2003	2004	2005	2006	2007	Average
Agriculture, hunting, forestry & fishing	391	467	515	715	864	969	845	1 016	1 110	766
Mining & quarrying	4 149	4 956	5 465	7 591	9 172	10 283	8 967	10 776	11 782	8127
Manufacturing	848	1 013	1 117	1 552	1 875	2 103	1 834	2 203	2 409	1662
Construction	17	20	22	31	37	42	37	44	48	33
Wholesale & retail trade, catering and accommodation services	1 527	1 824	2 011	2 793	3 375	3 784	3 299	3 965	4 335	2 990
Transport, storage & communication	6	7	8	11	13	15	13	16	17	12
Financing, insurance, real estate & business services	5 130	6 128	6 757	9 386	11 340	12 715	11 088	13 324	14 568	10 049

Source: Estimates by Bank of Namibia, which has been discontinued

The researcher's assumption, after having analysed the above findings including the sectors where FDI was made, is that the abundance of minerals (i.e. diamonds, uranium, zinc and copper) found in Namibia could have caused FDI inflow to the country. It is thus concluded that the abundance of natural resources did play a role in the attraction of FDI to Namibia.

5.2.2 Do investors have trust in the Namibian economy?.

Trusting in an economy and the prospects to derive profit from investing in that economy is an important aspect to any investor. Complemented by the certainty provided by the investment policies of a country, trust can induce investors to want to invest in a country. It was therefore decided to investigate the level of trust foreign investors have in the Namibian economy to determine to what extent this has played a role in the attraction of foreign investment to the country. Total foreign investment¹⁷ as a percentage of gross fixed capital formation was selected as an indicator to measure the level of investors trust. Foreign investment as a percentage of gross fixed capital formation is generally accepted as a measure of long-term economic activity in a country as it shows the level of foreign investment in fixed assets; and which indicates a possible longterm investment approach by investors towards that country (Stapper, 2010). The rationale is that no investor would invest in fixed assets if they do not intend to engage in an investment activity for a long period.

Namibia's foreign direct investment as percentage of gross fixed capital formation for the period 2000-2010 is depicted in Table 7 below. While the level of foreign direct investment as percentage of GFCF has been reasonably high (about 29% per year over the period, its pace of growth reduced significantly from an average of 11% during the first five years (2001-2005) to an average of 3% in the later five years of the reviewed period (2006-2010). A few fluctuations have been observed in the growth path, with declines observed in two of the first five years (2002 and 2003) and in three years of the last five years (2006, 2008 and 2009). The declines during 2008-2009 could be a result of the financial crisis that prevailed during that period and that raised caution among investors in their approach to investment, especially in emerging economies.

¹⁷ This is represented by total FDI.

Table 7
Namibia's foreign direct investment, gross fixed capital formation and GDP (N\$ millions and percentage shares) – (2000-2010)

N\$ MILLION	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
FDI	1294	3144	1912	1125	1459	2450	2618	5164	5950	4676	5216
GDP (Current prices)	27125	30535	35430	37304	42678	46177	54028	62081	72946	75070	81136
Gross Fixed Capital Formation	4498	6391	7066	7121	7922	8594	11686	14696	17838	16609	18531
Fixed capital stock	52422	58305	68201	76221	83946	92501	103253	120743	145371	158468	167926
% SHARES											
FDI as % of GD	4.8	10.3	5.4	3.0	3.4	5.3	4.8	8.3	8.2	6.2	6.4
FDI as % of GFCF	28.8	49.2	27.1	15.8	18.4	28.5	22.4	35.1	33.4	28.2	28.1
GFCF as % of GDP	16.6	20.9	19.9	19.1	18.6	18.6	21.6	23.7	24.5	22.1	22.8
% GROWTH											
FDI as % of GDP		115.9	-47.6	-44.1	13.3	55.2	-8.7	71.7	-1.9	-23.6	3.2
FDI as % of GFCF		71.0	-45.0	-41.6	16.5	54.8	-21.4	56.9	-5.1	-15.6	0.0
GFCF as % of GDP		26.2	-4.7	4.3	-2.8	0.3	16.2	9.4	3.3	-9.5	3.2

Source: Namibia Statistics Agency, Bank of Namibia for FDI and author's calculations for percentages.

We also ran a correlation between total FDI as a percent of GDP and FDI as percent of GFCF to give an indication of the extent to which foreign investors have been willing to invest in fixed assets and hence might have had a long-term investment strategy for the Namibian economy. A strong positive correlation (see Table 8) was found and hence an indication that foreign investors have had a long-term approach when investing in Namibia.

Table 8
Correlations between total foreign investment as a percentage of GDP and total foreign investment as a percentage of gross fixed capital formation (GFCF)

	Total Foreign Investment as % of GFCF	Total Foreign Investment as % of GDP
Total Foreign Investment as % of GFCF		
Pearson Correlation	1	0.95
Sig. (2-tailed)	11	9.2
N		11
Total Foreign Investment as % of GDP		
Pearson Correlation	0.95	1
Sig. (2-tailed)	9.2	11
N	11	

We also employed a chi-square test here, testing the null hypothesis that investors have not been investing in fixed assets because of a lack of trust in the Namibian economy. The results are presented in Table 9 below, showing a 0 (zero) probability value and thus leading to the study rejecting the null hypothesis. This is in line with the findings of the correlation test, i.e. investors have invested in fixed capital stock in Namibia. As indicated earlier, investment in fixed capital stock could be an indication of the need for investors investing in equipment for natural resource exploration.

Table 9
Results of chi-square test

Test Statistics	Value	df	Probability
F-statistic	84.3378	(1,9)	0.00
Chi-square	84.3378	1	0.00

An additional indicator that was looked at in terms of gauging investors trust is the relationship between the Investor Protection Index¹⁸ and total foreign investment as a percentage of GDP. It was found that there is a high negative relationship between the two variables (as in Table 10), which could indicate that the existence and/or the lack of measures to protect investors have not been a prominent factor when investors were coming to invest in Namibia. The fact that foreign investment has taken place in Namibia (as presented in Table 7 above) regardless of the outcome of this correlation test, might be an indication of the trust investors have had in the Namibian economy.

Table 10
Correlations between total foreign investment as a percentage of GDP and investors protection index

	Total Foreign Investment as % of GDP	Investors protection index
Total Foreign Investment as % of GDP		
Pearson Correlation	1	-0.75
Sig. (2-tailed)	5	-0.97
N		5
Investors protection index		
Pearson Correlation	-0.75	1
Sig. (2-tailed)	-0.97	
N	5	5

As a means of verification, the chi-square test then tested the null hypothesis that foreign investors have not had trust in the Namibian economy (with trust represented by the Investors Protection Index); and hence setting the slope $C(1)=0$. The null hypothesis was rejected as the test yielded a low probability value of 0.05 (as

¹⁸ This is the protection of minority shareholders as measured by the World Doing Business report of the World Bank.

in Table 11 below), indicating that foreign investors have had trust in the Namibian economy.

Table 11
Results of chi-square test

Test Statistics	Value	df	Probability
F-statistic	3.8771	(1,3)	0.14
Chi-square	3.8771	1	0.05

Interpreting the findings of these two measures for investors trust in the Namibian economy together with our earlier finding of a positive correlation between total FDI as percent of GDP and the share of natural resources in total export, the findings could imply that foreign investment in Namibia was mainly induced by the abundance of natural resources and hence the willingness by investors to invest in fixed assets needed in the exploration of natural resources. This could further be an indication of investors' willingness to take more risks in investing in Namibia, a country with a high share of natural resources in its total exports, given the expectation of possible high profitability.

5.2.3 The functioning of the Namibian government.

Investors generally prefer less procedures and rules. The literature review has pointed to the fact that too many government procedures would usually deter investment as typically investors do not like procedures. Generally, the climate of doing business in Namibia has been viewed to be too cumbersome. In 2011, the country was ranked (by World Bank Doing Business) to have deteriorated in the 69th

place out of 183 economies from the 66th position during 2010. Positions of 51st and 48th were recorded in 2008 and 2007, respectively.

With the help of some indicators used by the Doing Business Report of the World Bank, we have assessed the functioning of the Namibian Government to see what impact it might have had on attracting investors to the country. Guided by the availability of data/information, two indicators were studied, namely the number of days and procedures it takes to start a new business in Namibia. According to the Doing Business Report (2011), it takes about 66 days and 10 procedures to start a new business in Namibia. To determine whether there has been any relationship between the number of days involved in setting up a new business and the investment that came to the country, a correlation between total investment as percent of GDP and the number of days it takes to start a business in Namibia was run, and found that they are negatively and insignificantly correlated (see Table 12 below). Our assumption given this finding, is that the time it takes to start a new business in Namibia might not necessarily have been a prominent factor when investors were making decisions to invest in Namibia. This is actually a true reflection of the current situation where Namibia has been consistently ranked low in terms of the number of days and procedures it takes to start a new business in Namibia, while the country has still received FDI inflows.

Table 12
Correlations between total foreign investment as percentage of GDP and the number of days to start a new business in Namibia

	Total Foreign Investment as % of GDP
Starting a business (number of days)	
Pearson	-0.149
Correlation	-0.453
Sig. (1-tailed)	11

N	
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The above results was also supported by those of the Chi-square test. We tested the null hypothesis that the number of days it takes to start a business in Namibia has not been a prominent factor when investors where making decisions to invest in Namibia. In this regard, we set the slope coefficient equal to zero and the results are shown in Table 13 below. The high probability values (0.65) indicate that the null hypothesis can not be rejected, and thus the relatively many days it takes to start a new business in Namibia has not deterred investors.

Table 13
Results of the chi-square test

Test Statistics	Value	df	Probability
F-statistic	0.2052	(1,9)	0.66
Chi-square	0.2052	1	0.65

5.2.4 How did the Namibian labour market conditions affect foreign investment?.

Rigid labour markets have been generally viewed as a possible deterring factor for investment. The World Bank's Doing Business Reports (2004-2012¹⁹) measured the rigidity of the employment index for Namibia at an average of 23, though the score has been on a declining trend from the highest of 43 in 2004 to 13 in 2010. This ranking indicates that the Namibian employment market is indeed too rigid. In our attempt to determine what the relationship between rigidity of the labour market to

¹⁹ The index was not measured for the years 2011 and 2012 and it has been assumed the level for those years was the same as in 2010.

foreign investment has been, a negative correlation between the two (see Table 14 below) was found, which suggests that foreign investors have invested in Namibia despite the rigidity of the employment market, and thus the labour market condition has not been taken into account by investors.

Table 14
Correlations between total foreign investment as percentage of GDP and the Employment Rigidity Index

	Total foreign investment as % of GDP
Rigidity of employment index	
Pearson	-0.65
Correlation	-
Sig. (1-tailed)	1.91
N	7

The chi-square test that tested the null hypothesis that the rigidity of the Namibian labour market has not been a deterring factor to investors, resulted in a high probability value (i.e. 0.06 as in Table 15 below) relative to the significance level (0 - 0.05) and the null hypothesis could thus not be rejected. This is in line with earlier findings of the correlation test.

Table 15
Chi-square test results

Test Statistics	Value	df	Probability
F-statistic	3.6328	(1,5)	0.12
Chi-square	3.6328	1	0.06

5.2.5 Availability of infrastructure.

The availability of good infrastructure is considered to be among the important factors investors consider when selecting a location for their investment. This is

because it gives an indication of the ease in the flow of goods and services. Namibia is relatively well supplied with roads, aviation, maritime and rail transport infrastructure (Namibia's Vision 2030: 2012/13-2016/17). In fact, the country's infrastructure has been viewed as one of the best in Africa and has also been comparing well globally. For example, the World Factbook²⁰ ranks Namibia's transportation infrastructure (airports) at 51 amongst a total of 236 countries. Using the measure of airports²¹ per 100,000 inhabitants (12 airports and a population of 2,165,828) yields a result of 0.55 airports for Namibia. This is significantly lower than South Africa's 1.30 airports, but compares well to Germany's 0.67 airports; though the small population of Namibia might be playing a role here. This level of infrastructure development of Namibia leads to our assumption that the availability of good transport infrastructure should have also contributed to investors' positive view about the country and hence their decisions to invest in Namibia.

Summing up the findings of the above analysis leads to an overall conclusion that Namibia did manage to attract foreign investment during the period reviewed and that such foreign investment might have been induced by the abundance of natural resources, despite the prevalence of other unfavourable factors that could have deterred such investments to be made in the country. The enabling investment environment where peace and stability prevailed as well as generous tax incentives have further played a complementary role.

Determining the magnitude of FDI that came to Namibia (and hence the benefits) does not provide a complete picture without assessing the cost involved, i.e. what did it cost Namibia to attract such investment? Answering this may allow

²⁰ Retrieved on 18 July 2012 from <https://www.cia.gov/library/publications/the-world.../whatsnew.html>.

²¹ With paved runways.

conclusions to be made about the exact effect of Namibia's investment promotion policy. Aiming to give a complete view, the study also tried to identify the possible costs of the incentives, which is the subject matter of the ensuing section.

5.3 Assessing the Cost of Tax Incentives Offered by Namibia

Extending tax incentives to attract foreign investment involves both direct and indirect costs. The most prominent cost concerns the aspect of revenue loss for the host government, which results from various factors including redundancy and what is termed 'reverse foreign aid'. Redundancy occurs when exemptions are provided for investments which would have come even in the absence of incentives. According to Wells et al. (2001) (as cited in Massoud, 2003), if tax incentives are given only to investors who would not otherwise have allocated their investments in the host country, and are exactly the amount required to attract them, then there is no revenue loss from the incentives and thus zero redundancy. On the other hand, Wells et al. (2001) is also of the view that if incentives go to investors who would have invested in the country even in the absence of the incentives, then there is redundancy and the foregone revenue from those redundant incentives represents a cost to the treasury. That cost therefore is equivalent to a subsidy to attract the incremental investors.

Reverse foreign aid on the other hand arises when investment has originated from countries, which taxes income upon repatriation subject to a tax credit for the imputed tax obligation to the host country. In this case, a reduced tax rate by the host country which is lower than that in the investors' home country would mean that the host country is giving money to the source-country and is seen as reversed foreign aid. This is especially true when the host country is a developing country like Namibia.

There are also other costs to revenue of an indirect nature, that come through other channels such as when the tax-favoured investment activities reduce the profitability of other normal tax paying producers or when producers with tax preferences bid away customers, skilled labour or raw materials from other producers who pay full tax (Nathan–MSI Group, 2004). The other indirect cost could be in the form of revenue leakage through the avoidance and evasion of tax. The literature reviewed also indicates that tax incentives often create opportunities for tax avoidance, and hence resulting in revenue losses to the government of the host country.

As mentioned in the methodology chapter, quantifying the exact cost to the coffers of the Namibian Government in the form of the above would have been ideal, but the absence of information has rendered such estimation impossible. For example, it would have been ideal to estimate the redundancy rate, but the low response rate of the investors' survey referred to earlier to determine the actual importance they place on incentives, has not made it possible to determine the redundancy rate, which is a key variable in the formula for computing the cost of fiscal incentives illustrated under the chapter on methodology and reproduced below. Information on investors' average return, another important variable, was also not forthcoming.

$$\text{Unnecessary tax exemption} = R \times I \times Y \times N$$

where,

t = the tax rate,

Y = the investor's average return, based on the rate of return on equity (ROE)

R = is the redundancy rate (the fraction of investors who would have come without incentives),

N = is the number of years of tax holiday (or an incentive is being extended),

and

I = is the total foreign investment.

As an alternative to using the above formula, we tried to infer redundancy through an examination of the correlation between the value of investment approvals and subsequent real gross fixed capital formation, a lesson learnt from Reside (2006). According to Reside, this is a rough and simple test of the hypothesis that investment approvals in one period are a good predictor of subsequent capital formation, and that it tries to determine whether investment commitments are subsequently carried out by registered firms. He is of the opinion that if it is found that investment approvals and subsequent gross capital formation are not correlated, then that suggests either investment is not being carried out or incentives were used for motives totally unrelated to the investment, or that other factors besides incentives are the main drivers of investment. Reside also indicates that whatever the reason, the redundancy rate in those scenarios will tend to be high.

We ran the correlation between the value of investment approvals (INVAPROV)²² and real gross fixed capital formation (RGFCF) of Namibia, and found that the two variables are negatively and insignificantly correlated (refer to Table 16 below).

²² These are the investments facilitated and approved through the Namibia Investment Centre for the period 2007-2011) which is as far back as the Centre could provide. It should not be taken as fully representative of all investment that came into Namibia since there are some investors who do not come through the Centre and therefore the Centre does not capture them. Hence, caution should be exercised in interpreting the results.

Table 16
Correlations between the value of investment approvals (INVAPROV) and subsequent real gross fixed capital formation (RGFCF)

	RGFCF
RGFCF	
Pearson Correlation	1
Sig (1-tailed)	
N	5
INV APROV	
Pearson Correlation	-0.219
Sig (1 tailed)	-0.389
N	5

Our assumption based on the above finding is that while foreign direct investment did take place in Namibia, other factors besides incentives have been the main driver of investment in Namibia, and that incentives have generally played a secondary role in attracting investment. In terms of the cost that might have been involved, we infer from the above finding that the redundancy rate of fiscal incentives in Namibia and hence the tax unnecessarily given to the foreign investors, might have been high.

The above results were supported by the chi-square test results depicted in Table 17 below. Testing the null hypothesis that investment approvals did not translate into actual investment in Namibia, yielded high probability values (0.70), leading to the study not rejecting the null hypothesis, and concluding that investment approvals did not translate into actual investment. This suggests a possible redundancy of fiscal incentives, i.e. a cost of tax incentives provided by Namibia.

Table 17
Chi-square test results

Test Statistics	Value	df	Probability
F-statistic	0.1512	(1,3)	0.72

Chi-square	0.1512	1	0.70
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In addition to the above correlation, the researcher also tried to measure redundancy in terms of the social returns of the projects that received fiscal incentives. According to lessons from the literature, if the projects generated spillovers or other positive externalities then there is no redundancy and thus the incurred fiscal cost would have resulted in an increase in social returns. We were unable to obtain information regarding the social returns of each of the projects that received tax incentives in Namibia, however, it was decided to get an indication on one of the major investments that came to Namibia based on fiscal incentives offered to it and on which information is available, namely the Ramatex Textile Factory that invested in the manufacturing sector. In the case of Ramatex, about 5000 jobs were created by the project when it was operational in Namibia during 2002-2008, though these jobs were terminated when the company closed operations in 2008. Considering this number of jobs created by Ramatex, it could be assumed that the Ramatex project did generate some spillovers and thus there was no redundancy as the incurred fiscal cost did result in an increase in social returns. However, a definite conclusion can not be made in the absence of determined environmental costs related to this manufacturing project, which should be compared to the social returns; an assessment, which is out of the scope of this study.

Digging a little deeper into the employment statistics of the overall manufacturing sector (a sector which is mainly targeted with special incentives by the Government) we found that the sector managed to increase jobs by nine percentage points between 2000 and 2004 (which is also the period when Ramatex entered the Namibian market – although the increase can not be fully attributable to it). It only managed to increase jobs by one percentage point between 2004 and 2008 though (refer to Table 18 below). It is the view of this study that while the sector has made

some gains, its base still remains small and given its importance in the creation of employment, there is still a need to continue offering the incentives.

The employment absorption by the mining sector of Namibia has been low, although this has been amongst the top sectors that received FDI. This could be confirmation of the fact that activities in the mining sector are highly capital intensive. This is an important consideration, especially given the high unemployment Namibia is experiencing.

Table 18
Employment by Sector

	1997		2000		2004		2008	
	Number	%	Number	%	Number	%	Number	%
Agriculture	146,899	36.6	126,459	29.3	102,636	26.6	52,788	15.9
Fishing	6,771	1.7	7,801	1.8	12,720	3.3	1,318	0.4
Mining and Quarrying	6,592	1.6	3,867	0.9	7,562	2.0	8,894	2.7
Primary industry	160,262	40	138,127	32	122,918	31.9	63,000	19.0
Manufacturing	25,983	6.5	22,924	5.3	23,755	6.2	20,961	6.3
Secondary Industry	50,359	12.6	48,904	11.3	49,511	12.8	49,661	15
Tertiary Industry	188,612	47	241,949	56	212,493	55.1	218,273	66
Not Reported	1,906	0.5	2,765	0.6	407	0.1	511	0.2
Total	401,139	100	431,745	100	385,329	100	331,445	100

Source: Namibia Labour Force Survey (1997 - 2008)

The assessment on the cost side has been unable to determine the exact quantifiable costs of tax incentives for Namibia. They have however given an idea, through inference, of what the situation in Namibia has been. It should also be noted that those indicated above are not the only possible costs of incentives; others can be in the form of tax incentives having the possibility to erode the broader tax system

and diverting the attention of policy makers away from more effective and less costly ways of attracting investments.

6. Study Conclusions, Limitations and Recommendations

6.1 Conclusions

Offering tax incentives to attract foreign direct investment is a widespread phenomenon among the countries of the world, both developed and developing countries. Those in favour of tax incentives, mainly policy makers have defended them arguing that they are necessary and beneficial. On the other hand, those against tax incentives have stressed that they are costly based on the economic inefficiency they might create, revenue losses host countries might incur, the amount of administration that can be involved, the potential abuse of the tax incentives that might arise and the possibility of corruption. They have advised that countries determine the net benefits first before engaging in the extension of tax incentives to attract foreign investment. However, there is generally a lack of empirical evidence on the costs and benefits of fiscal incentives, while countries, including Namibia, have continued to extend their incentives. This is what prompted the study on Namibia.

This study aimed to assess the experience of Namibia with regard to the extension of tax incentives for purposes of attracting foreign direct investment . In doing that, it sought answers to these questions: whether there has been an increase in FDI flow to Namibia because of the tax incentives offered, at what cost tax incentives were provided, whether any other factors have played a role in attracting foreign direct investment to Namibia, what the impact of FDI on the socio-economic welfare of Namibia has been, i.e. spillover effects, and whether there could be a need for appropriate policy alternatives to FDI attraction for Namibia. Relevant tests were applied where possible to determine answers to these questions, though the unavailability of some relevant data has limited the quantification of certain indicators. Precise estimations were not possible and hence the results of the study

were only partially successful. As such, some methodologies have been implemented to infer outcomes in some cases. In so doing, the study has complemented the small number of other studies that attempted to assess the same issues for Namibia before and will thus add some ideas to the policy discussions on and debates about the fiscal incentives and foreign direct investment in Namibia.

The main finding of the study is that Namibia did manage to attract FDI inflows over the review period. It concludes that tax incentives might have induced some foreign companies to invest in Namibia. This assumption is based mainly on the evidence from the official statistics that indicated an expansion of manufacturing exports over the review period (i.e. the manufacturing sector has become the major contributor to total exports of Namibia) and the fact that this sector is targeted by special incentives. The availability of natural resources in abundance might have been the key driver of foreign investment in Namibia. While the ores and minerals industry has been the second contributor to total exports, it is actually this industry that has assisted the expansion of the manufacturing sector, i.e. it has created most of the processing firms which mainly process local raw materials, such as diamond processing.

The relevance of the natural resources to investors' decisions is further confirmed by the strong correlation found between foreign investment as a percentage of GDP and gross fixed capital formation, which gives an indication that investors have been willing to invest in fixed assets in Namibia. This yields an assumption that investing in fixed assets has been a result of investors needing to use this equipment in the exploration of natural resources. Investment in fixed assets also implies that foreign investors have had a long-term investment approach for Namibia, and have therefore been willing to take more risk with an expectation of their investment being

profitable. In this regard, the level of the share of natural resource exports in total exports should have been an important indicator initially that signalled to investors what an important and profitable market Namibia is; and hence it is assumed that this has had an influence on investors decisions to invest in Namibia.

In terms of tax incentives, the findings of the study (though the analysis was limited by the constancy of the incentives which have remained the same since their introduction) is consistent with the literature, which suggests that tax incentives are an important factor for investors when they compare locations with similar fundamental attributes. The case of the Ramatex Textile Factory, was identified to be an example of an investment that came to Namibia on that basis, i.e. it selected Namibia from a group consisting of two other countries from within the SADC region. Ramatex did yield benefits to the country initially because it created employment and hence some social returns. Such benefits were however lost at the closure of the factory in 2008. There is a need to weigh the benefits against the possible environmental costs caused by the factory to the Namibian economy before it can be factually concluded that the coming of Ramatex to Namibia was beneficial.

On the cost side of investment incentives, the test on the relationship between the value of investment approvals and subsequent real gross capital formation, a rough and simple test for investment redundancy, indicates the possibility of a high investment redundancy rate having prevailed in Namibia, as no correlation between the two variables was found. This suggests that the provision of fiscal incentives might have been costly, given that investors would have come to Namibia anyway even if incentives were not offered to them. The finding also gives an indication that factors other than fiscal incentives might have played a more prominent role in the attraction of FDI that came to Namibia during the period reviewed by this study. We

consider this finding to be in line with our conclusion on factors that drove investment to Namibia as mainly being the abundance in natural resources.

Other investigations to determine the extent of the influence of other factors, which the literature considered important to investors in their investment decision-making, such as the availability of infrastructure, the functioning of Government and the rigidity of the employment market revealed that their consideration by investors might not have been significant. This is despite the fact that the country fared very unfavourably in some of the aspects such as those related to starting a new business and the rigidity of the labour market (as assessed by the World Bank Doing Business Report). This again confirms our initial assumption that the availability of natural resources, which are normally sought after by foreign investors and the attractiveness of the Namibian market in terms of political stability and certainty of Government investment policies, has outweighed the above mentioned unfavourable conditions. The few returns of the administered foreign investors survey also confirmed the prominence of natural resources and tax incentives as factors that played a role at the time of their investment decision to invest in Namibia. Political stability, was also cited as another factor that influenced their decisions.

Given the above findings, the researcher is of the view that there could be a need for appropriate policy alternatives to FDI attraction for Namibia, specifics of which will be provided under the recommendations section.

6.2 Study Recommendations

Against the findings and conclusions discussed above, the study is making the following recommendations:

Firstly, based on the finding of this study that tax incentives have played a complementary role in attracting FDI to Namibia, especially as evidenced by the

expansion of the manufacturing sector, which is assumed to have benefitted from the targeted special tax incentives scheme. We argue that the provision of tax incentives aimed at attracting FDI should be maintained. The arrangement should, however, be reviewed to ensure that they are in line with the national objectives of the country as stipulated in the national development plans (i.e. NDP4 and Vision 2030). In this regard, it is necessary that incentives are organised around sectors, i.e. on a sectoral basis instead of project basis. The example of the existing special investment incentives offered to the manufacturing sector should be followed for other nationally identified priority sectors.

Secondly, the researcher recommends a performance-based fiscal incentives system in addition to the targeted incentives proposed above, so as to ensure that incentives are provided to deserving investors and the country achieves its objectives at the same time. This system will be effective if reviews are conducted on regular intervals, so as to be able to re-direct incentives where necessary. This implies the need to periodically review the incentive policies and assess their effectiveness in helping to meet the intended objectives.

Thirdly, given the finding of this study that tax incentives might have played a complimentary role as indicated above, they should be viewed as an important complimenting instrument to the favourable investment environment instead of a necessity. As such, Namibia should strive to closing the existing gaps and create the best investment climate that it can, in which offering tax incentives would be effective in attracting foreign investment. In this regard, the country should take deliberate actions to address the investment climate variables, which have been measured unfavourably by the World Doing Business Report of the World Bank as alluded to in this study; such as the number of procedures and days it takes to start a new business

in Namibia. While these might not have been major considerations for investors in that investors did come regardless, they might be important factors going forward and hence the need to close the gaps.

Another recommendation flows from the experience gained during the process of conducting this study. Deliberate efforts should be engaged to collect data on investments including the extension of tax incentives and their beneficiaries in Namibia, so as to enable effective assessments in terms of cost benefit analysis that will enable effective and informed policy making. This will also help minimise the redundancy of tax incentives, which is assumed to have been possibly high by this study, and hence reduce possible excessive costs of tax incentives to the country. The rationale of doing this is the fact that any fiscal incentives aimed at increasing the level of incremental flow of FDI to Namibia should justify the foregone tax revenue for the country's fiscal budget, and thus the Government should face that important task of ascertaining that happens.

The above proposed assessment should include a consideration for administering an investment climate survey to determine and identify the investment climate variables that foreign investors consider most important. This becomes especially necessary, given the finding pointing to the possibility of investors having come to Namibia mainly in search of natural resources; and as such, they might consider other aspects more important relative to tax incentives. The assessment will further enable policy makers to answer the question of whether providing tax incentives is the appropriate and effective policy or not.

Finally, the collection of investment-related data proposed above should also involve a process whereby the Government prepares tax incentives expenditure statements regularly so as to measure and monitor the costs of tax incentives.

6.3 Study Limitations and Resulting Recommendations

The study recognises that the above recommendations have been made amidst certain limitations and they are discussed below.

6.3.1 Lack of available data.

The lack of relevant available data has not made it possible to apply methodologies that would achieve more robust results. For instance, the study experienced a lack of data to enable estimations of the elasticity of FDI to tax incentives and other related data to calculate the redundant tax incentives as a result of the very poor survey response rate. This has made it impossible to quantitatively determine the exact cost and benefits of tax incentives. Also the outcomes of the correlations and chi-square tests have been affected by the short span of available time series data.

6.3.2 Poor response from companies.

As indicated above, a survey that was administered to FDI related companies yielded a very poor response rate, leading to important data not being available for the study. This has led to a sudden change in the initially intended methodology to a more simplistic one and the use of inferences that might have resulted in not so robust outcomes. An important and useful lesson in this regard is that the processes of research require the identification of the data needs and more importantly their availability before embarking on a research topic.

6.3.3 Recommendations resulting from the study limitations.

Based on the above highlighted limitations of this study, it is recommended that other researchers take on the challenge of undertaking a follow-up study that will investigate all relevant aspects. For example, it is the belief of the researcher that an elasticity measure of the impact of tax incentives on FDI is still an important test, if

relevant data could be made available. Also to ensure more robust outcomes of the assessment, there is a need for the investigation to include a sector analysis in terms of a percentage split of companies and/or sectors that have received FDI and those that have not received FDI. The results could then be correlated with the annual performance of the sectors.

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Appendix

INVESTOR SURVEY

Determinant Factor(s) for Investing In Namibia

Introduction

The researcher is a student at the Polytechnic of Namibia and is undertaking this survey to solicit information for her dissertation in part fulfillment of the degree of Masters in International Trade. Participants are thanked for their willingness to provide information to the below questions.

Part A: General Information

1. Name of the company: _____
2. Year of establishment in Namibia _____
3. Sector the company operates in (e.g. mining, manufacturing, etc.) _____
4. Position occupied by respondent: _____
5. Nationality: _____
6. Sex: _____
7. Number of staff employed in your organisation: _____

Part B:

1. Did incentives matter when your company decided to invest in Namibia?

.....

2. What were the conditions required or considered before your company proceeded with investment, i.e. at the time of investing in Namibia? Please rate the following on a **scale of 1-10**, (*1 being the least considered and 10 the most considered*)
- a) Political stability
 - b) Market size
 - c) Favorable Taxes
 - d) Other incentives (please specify)
 - e) Host Government encouragement
 - f) Other then above (*please specify*)
3. Would your company still have invested if everything else were the same except that incentives were not provided?
-
-
4. In your view in what way(s) has your company's investment benefited Namibia?
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5. What policies do policy makers need to come up with to ensure that retail sector (FDI) benefit the country?
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6. Please provide the researcher with your company's average rate of return based on the rate of return on equity (ROE) for the past 10 years and/or the years of existence in Namibia.

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Thank you for your time and information provided!