

Dependency Theory to the Study of Foreign Direct Investment (FDI) and Its Relevance to the Horn of Africa: A Matthew Effect?

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Abstract
The central aim of the paper is to test the relevance of dependency theory in studying FDI and to achieve the main objective, the study employed qualitative case study design through dealing with wide ranges of secondary sources. The collected data were analyzed through thematic comparative analysis. This paper thus found out that the decreasing trade openness, low infrastructure development, macro-economic instability, low level of return on capital and exchange rate, increment of inflation rate proved that FDI in the horn of Africa has brought development inconsistency while a conspicuous profit and wealth for the affording states or institutions. Thus, dependency theory weighs more in explaining the relevance of FDI in the horn of Africa than its contemporary theories. Albeit, this paper counter argue the idea of dependency theory that foreign direct investment is wholly beneficial to Africa maintaining that a host state can achieve development incorporating FDI.
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INTRODUCTION

Investment is without a doubt, one of the primary engines of development in all economies. Foreign direct investment (FDI) remains a significant source of capital and income-generating opportunities for the least developed countries (Asiedu, 2006). This is especially true for the Horn of Africa that does not have enough domestic funds to finance huge investment projects. It is also important for Ethiopia in transferring technological advancement for domestic enterprises; competitiveness and organizational forms assist human capital formation, international trade integration and create a more competitive business environment from abroad (Getaneh, n.d.)

FDI in the Horn of Africa started to grow since the 1990when different regimes sought to eliminate the constraints on FDI to establish an enabling environment for foreign investors through the liberalization of control of the economy in 1992 (*Foreign Direct Investment, Finance and Economic Development - Chapter - Faculty & Research - Harvard Business School*, n.d.). In 19 70s governments adopted Structure Adjustment Program (SAP) as per the recommendation of the World Bank (WB) and International Monetary Fund (IMF). The governments promised to implement a series of policy reform measure to remove and change the economic system with the market-based economy, to open the economy into the world economy and to encourage the wider participation of the private sectors in the development process of the national economy (UNCTAD, 2017; ADBG, 2000).

When it comes to theories, scholars for long have been endeavoring to study FDI by employing different theories for different issues; however, every theory fails to show the quandary and exact nature of FDI. In addition, the failure to address the basic questions of FDI that are pertinent in the study necessitates a relatively inclusive theory that engulfs the whole in a single perspective. Thus, this paper follows dependency theory and to achieve the main objective, this paper adopts retrospective prospective methods of analysis since the study of FDI requires a thorough

Dependency Theory

Before elaborating on the nature of the dependency theory, I briefly explain the main characteristics of a good theory, the discussions and the limitations of each of the three theories above, and show why the critical political economic theory is preferred and adopted in this paper in such discussions. According to some authors (Mittelstaedt, 1977; Zaltman & Wallendorf, 1979; Wacker, 1998), a theory comprises of a statement of relations among factors observed in the empirical world. This provides a systematic way to understand events, behavior, or situations. Therefore, a theory has to explain or predict events. The author usually find that the outstanding features of a theory falls in features such as explanatory powers, predictive powers, factual, general unity powers, and apparent validity.

Table 1: Characteristics of a Good Theory

Characteristics	Explanation
Explanatory power	A good theory should possess the ability to tell why and how a specific relationships leads to specific events.
Predictive power	A good theory should have the capability to forecast what will occur at some future time provided certain conditions are met.
Factual basis	A good theory should be supported by facts.
General	A good theory should be broad so as to cover a wide range of relevant situations.
Unifying power	A good theory should have the capability to bring together areas which have previously been viewed as unrelated.
Validity	A good theory must be verifiable, in the sense that it should be possible to test the relationships hypothesized by the theory.
Simplicity	A good theory should be simple enough that it can be understood.

Adapted from Mittelstaedt (1977), Zaltman & Wallendorf (1979) and Wacker (1998)

One of the theories (classical theory) maintains that foreign investment is wholly beneficial to the host state while the other (dependency theory) maintains that a host state cannot achieve development unless it turns away from dependence on foreign investment. The conflicting economic theories had a definite impact on the articulation of the legal principles, and it is necessary to understand these theories.

Denisia (2010) for instance suggests that theories of FDI can be split into two groups; Micro-level determinants of FDI and Macro-level determinants of FDI. The micro-level theories of FDI are production cycle theory, the theory of exchange rates on imperfect capital markets, the internalization theory, and the eclectic theory (Jebessa, 2017; Jugurnath, et, al 2016). These determinants of FDI try to provide an answer to the question of why MNCs prefer opening businesses in foreign countries rather than exporting or licensing their product (Meskerem, 2016; Mamo, 2008). The Macro levels determinants of FDI clarify the host countries' situations that determine the inflow of FDI. Macro-level theories are Capital Market Theory, Dynamic Macroeconomic Theory, FDI Theories Based on Exchange Rates, FDI Theories Based on Economic Geography, FDI Theories Based on Institutional Analysis macro-level theory of FDI (Jugurnath, et, al 2016).

Besides, Makoni (2015) pointed out Macroeconomic FDI theories emphasize country-specific factors, and are more aligned to trade and international economics, whereas microeconomic FDI theories are firm-specific, relate to ownership and internalization benefits, and lean towards industrial economics, market imperfections bias. On the other hand, as I have mentioned the above theories on FDI are organized into three schools. The first two are traditional schools of development thinking & the dependency schools and the third one is the integrative school known as critical economic perspective (Jebessa, 2017; Wilhelms, 1998).

The classical economic theory on foreign investment takes the position that foreign investment is wholly beneficial to the host economy. Several factors are relied on to support this view. The fact that foreign capital is brought into the host state ensures that domestic capital available for use could be diverted to other uses of public benefit (Solow, 1956). The foreign investor usually brings with his technology, and this leads to the diffusion of technology within the host labor force that is so employed will acquire new skills associated with the technology introduced by the foreign investor, Skills in the management of large projects will also be transferred to local personnel (Sornarajah, 2004; Rostow, 1995). Infrastructure facilities will be built either by the foreign investor or by the state and these facilities will be to the general benefit of the economy. The upgrading of facilities such as transport, the health of education for the benefit of the foreign investor will also benefit society as a whole (Legese, 2019).

According to the classical perspective of FDI, the potential for technology spillovers from FDI is a positive externality of FDI that host countries hope to benefit from. Blomström and Kokko (2003) suggest that the possibility of technology spillover is one of the major reasons host country governments try to attract FDI inflows. The effects of FDI inflows on the host country are reflected in economic growth. Based on this he argues that technology spillovers provide the strongest potential for FDI to enhance host country economic growth (Andreas J. and Jonkoping 2005).

A critical political economy is a form of analysis that attacks the status quo, dominant paradigm, ideology (Gandy, 1992). It is argued that a critical redefinition both of classical political economy and of the Marxist approach is required to understand the economy of the twenty-first century (Buzgalin and Kolganov, 2015). It is hypothesized that theoretical innovations are required for an adequate investigation of the new world of creative work and a knowledge-based society. These innovations are, in particular, the political-economic theory of the total corporate-network market and new proofs of the antagonism between market and creativity. The objective of this theory is to show that when renewed in a critical spirit, classic works of political economy can provide meaningful answers to the challenges of a new epoch. Their critiques are focused on what they see as flaws in theory and method principally demonstrated through comparisons of the ideal with the reality. At a second level, these critiques attack the normative dimensions of the neoclassical paradigm (Gandy, 1992).

Another strategic response by radical political economists has been to go on the attack and demonstrate in a forceful and compelling that the dominant neoclassical paradigm is fatally flawed, lacks logical consistency, generalization, and fails its test of falsifiability. Thus, it is argued, one can only explain the continued position of dominance that the neoclassical paradigm enjoys as a function of its status as an ideological tool of capital (Gandy, 1992). The animosity which is directed at multinational corporations is the bases of among others the dependency theory. This animosity has become somewhat dented in recent times. In an age where communism has proved unsuccessful and the superiority of a free market economy to marshal the means of production is gaining acceptance, theories that are hostile to the private initiative as the means of generating growth are unlikely to make headway. With the increasing privatization of state companies happening in developed as well as developing countries and the progress of the capital markets in most developing countries, there has been a shift away from ideological predispositions towards foreign investment (Dunning,1993).

Many states have seen more wisdom in a pragmatic approach to the problem than indefinite ideological stances (Sornarajah, 2012; Wilhelms, 1998). The fear that multinational corporations pose a threat to the sovereignty of developing states has retreated with the increasing confidence of the developing states in managing their economies. Multinational Corporations have also left behind the role of being instruments of the foreign policy of their home states. On accessions, they have even formed alliances with developing countries to the detriment of their home states. But, some of the larger multinational corporations are capable of conducting foreign policy for their benefit (Sornarajah, 2012).

Most of the theories focus on explaining, with limited success, on motivations for FDI from developed country perspective. These studies largely examine either why FDI flows from a developed country to a less developed country, or newly industrializing economy or another developed country. Most theories used so far essentially put forward that for FDI to occur, investing firms need to have certain unique advantages or resources, so as to be able to overcome disadvantages of operating in a foreign location and be able to compete with host country firms (Hymer, 1976). However, the driving force behind FDI by firms from less developed countries is not well understood (Kumar, 1981). For example, the rise MNCs from emerging countries like China, India, Brazil, Taiwan, South Korea and Turkey have challenged existing theory which fails to explain how do such firms that start small, lack key resources challenge established positions in the global economy and dislodge existing MNCs.

Recent studies, however, have suggested that the impact of FDI on income inequality is determined by local conditions in the host (receiving) countries, particularly in terms of absorptive capacity, human capital, technology diffusion and the quality of its institutions (Schneider and Soskice, 2009; Wu and Hsu, 2012). Absorptive capacity has been measured by the quality and production of electricity, air transport, mobile phone subscriptions and international internet bandwidth. Human capital is measured by the enrolment rate in tertiary education and the percentage of internet users. The indicators associated with local innovation and levels of technology are used as a proxy for technology diffusion. Lastly, institutional quality includes public and private institutions. (HAILU, 2010)

The Relevance of Dependency Theory to the Horn of Africa

Based on the theoretical arguments mentioned above, particularly of the dependency theory, here are some of the reasons to infer this theory may provide key useful insights in to the horn of Africa.

1. Dependency theory is opposed to the classical theory and takes the view that foreign investment will not bring about meaningful economic development (Dixon and Boswell, 1996). It was a theory popularized by Latin American economists and political philosophers (Haggard, 1989). The theory focuses that most investment is made by multinational corporations that have their headquarters in the developed states and operate through subsidiaries in developing states. The proposition is that the multinational devise global policy in the interests of its parent company and its shareholders in the home country. As a result, multinational corporations come to serve the interests of the developed states in which they have their headquarters (Getahun, 2014). The fear among workers and labor unions is that investments abroad by source country firms may result in the production facilities being closed down and that workers could be made redundant in the source country. This fear is normally based on the idea of domestic production being shifted abroad to take advantage of lower labor costs. The discussion of host country employment effects can therefore not be separated from a discussion of employment effects in the source country (Andreas J. and Jonkoping, 2005).

According to Jebessa (2017), the dependency school flourished between the 1960s and 1980s. Its focus on the consequences of foreign direct investment in developing countries was its major contribution to the concept and impact of FDI. The dependency school consists of dependencies (neo-Marxist) and structuralism theories. According to the dependencies (neo-Marxist) sub school international trade and the multinational companies exploits developing countries through deteriorating terms of trade and transferring profits out of developing economies respectively (Dixon and Boswell, 1996 cited by Tilahun, 2019). The structuralism sub school, on the other hand, assumes that industrialized countries and domestic centers (national capital) extract resources from the periphery, namely the poor countries or local countryside (Accolley, et al, 1997). This theory has an inherent limitation to show the reality that foreign investors more often consider the possible ways of increasing the exploitation and minimizing the relative costs of the operation to carry out. Moreover, this theory fails by pinning the blame (i.e. Third world countries' economic failure) solely on the foreign investors while camouflaging the blame that authoritarian regimes should have taken. Yet, it elucidates the realm of Africa in general and the Horn of Africa in particular.

2. Africa's experience on foreign direct investment (FDI) presents a paradox. Conventionally, capital is expected to flow from countries with low to high returns. During 2006-2011, the region experienced the highest rate of return on FDI (11.4%) compared to 9.1% in Asia, 8.9% in Latin America and the Caribbean. The world's average was 7.1%. Yet Africa's share of the global net FDI has been very low over the past decade (*(PDF) Addressing the Foreign Direct Investment Paradox in Africa*, n.d.)

Politically, these patterns are perceived as having two major sets of implications. First, they undermine the autonomy of the periphery. Multinationals and international lending agencies become major, if not dominant, forces in economic policy making, a position they maintain by means of an implicit threat of withdrawal from, and consequent loss of capital by, the host country in the periphery. (*Dependence on Foreign Investment and Economic Growth in the Third World on JSTOR*, n.d.) Moreover, new groups emerge that are linked to the core, while the remainder of the periphery population becomes increasingly marginal, in both economic and political terms. Thus, an understanding of the relation between economic dependence and economic growth is important both for its own sake and because this relation is widely believed to have far-reaching indirect effects on patterns of political development (*Dependence on Foreign Investment and Economic Growth in the Third World on JSTOR*, n.d.)

Following the work of Baran, Frank, and others, claimed the dependency approach is generally taken to imply that foreign investment depresses growth. The core-periphery relationship is considered exploitative, in that profits are transferred back to the core rather than rein- vested in the periphery; economic dependency thereby contributes to the "underdevelopment" of the periphery. At the same time, the external orientation of periphery economies encouraged by foreign in- vestment is said to generate internal distortions and contradictions that retard growth. Growth is therefore slower in the periphery than it otherwise might be. (Kurtishi-Kastrati, 2013)

According to the dependencies (neo-Marxist) sub school international trade and the multinational companies exploits developing countries through deteriorating terms of trade and transferring profits out of developing economies respectively (Dixon and Boswell, 1996 cited by Tilahun, 2019). I would defend Dixon's idea because of the fact that exploitation of FDI can happen on a number of levels. Politically speaking, a foreign government may choose to seize the investment. The case of Ethiopia amplifies the assumption. The cancellation of Ethiopia from AGOA was purely a political motive and was done in the name of FDI and free trade areas. Moreover, assets or proprietary information might be seized for political purposes. The foreign company might take the investment and squander it. Even if there is a well-constructed contract governing the terms and conditions of the investment, some foreign companies may decide to take the money and run. That can leave an investor with few, if any, options to recover their funds.

In 2018, FDI flows to Sub-Saharan Africa decreased by 10 per cent in 2019 to $32 billion. This decrease can mostly be attributed to a decline in investment flows to traditional major investment recipients, including Nigeria, South Africa and Ethiopia (UNCTAD, 2018). Due to the influx of items from FDIs, several products produced in cottage and village industries, as well as small scale enterprises, had to be phased out of the market. Local drinks and indigenous products are epitomes for such disadvantages of FDI.

Foreign direct investments contribute to the country's pollution problem. Some of the rich countries' pollution-producing sectors have relocated to developing countries. Automobile industries are the main victims. The majority of these have been relocated to underdeveloped countries, where they have avoided contamination. Exponentially, FDI to East Africa dropped to $6.5 billion, a 16% decline from 2019. Ethiopia, despite registering a 6% reduction in inflows to $2.4 billion, accounted for more than one third of foreign investment to East Africa (*Investment Flows to Africa Significantly Cut by Pandemic, Says UN Report | UNCTAD*, n.d.).

Foreign Direct Investment (FDI) is one of the causes of exchange rate fluctuations. Because of the presence of FDIs, Horn regions have been experiencing currency crises since 2000. Exports have plummeted as a result of inflation, resulting in a sharp drop in the value of the native currency. As a result, FDIs began to withdraw their capital, resulting in a currency crisis. As a result, too much reliance on FDI will result in a currency crisis. Foreign direct investment has also contributed to the country's inflation. They invest a significant amount of money in advertising and consumer promotion. This is done at the expense of consumers, resulting in a price increase. They also form cartels to gain market power and exploit consumers. OPEC, the world's largest cartel, is an example of FDI exploiting consumers.

The introduction of TRIPs (Trade Related Intellectual Property Rights) and TRIMs (Trade Related

Investment Measures) has restricted the production of certain products in other countries. For example, India cannot manufacture certain medicines without paying royalties to the country which has originally invented the medicine. The same thing applies to seeds which are used in agriculture. Thus, the developing countries are made to either import the products or produce them through FDIs at a higher cost. WTO (World Trade Organization) is in favor of FDIs. And FDI are insisting on total convertibility of currencies in under-developed countries as a prerequisite for investment. This may not be possible in many countries as there may not be sufficient foreign currency reserve to accommodate convertibility. In the absence of such a facility, it is dangerous to allow the FDIs as they may withdraw their investments the moment they find their investments unprofitable.

Authors suggest that the advantages and disadvantages of FDI can be manifested through trade openness, helping the host states secure strategic products, ability of diversifying foreign trade, extricating dependency from internationally dominant economic players, economic espionage and unemployment. Accordingly, this paper strives to amalgamate these variables with dependency theory and show how much it explains the reality in Africa.

Literally, the total of imports and exports normalized by GDP is known as trade openness. Bilateral equity investment is substantially associated with underlying trade patterns, according to Mishra and Lane and Milesi-Ferretti cited in (Alotaibi & Mishra, 2014) . Through trade, investors can better obtain accounting and regulatory information on overseas markets and thereby invest in foreign assets. Tighter trade integration also reduces the danger of default.

However, the truth in Africa is the other way round for there is a significant discrepancy between the total imports (goods and services as part of FDI) and exports. Against the claim that FDI paves a way for trade openness, two manifestations are shown in the economic life of Africa. One is the instability of economic power. Since the beginning of FDI, half of the African continent is impoverished. Per capita GDP in Sub-Saharan Africa is presently smaller than it was in 1974, having fallen by more than 11%. In addition, the inability to finance defense needs also looms large and shows the evil facet of foreign direct investment.

To substantiate the above statement, Africa today is a consumer of finished technology products manufactured in other parts of the world, but the continent contributes very little value to humankind's technological progress. Given the devastating impact of Africa's dependence on public services on continental educational institutions, there is no hope of a turnaround.

Despite the fact that FDI benefits host countries through spillovers from productivity gains resulting from the diffusion of knowledge and technology from foreign investors to local firms and workers, lower prices, and efficient resource allocation, in addition to direct benefits such as investment, employment, and foreign exchange, it has negative spillover effects such as competition for limited trained labor and the eviction of local enterprises due to, among other things, technological intensity (Farole & Winkler 2014).

I would argue that in order to attract financial capital, Africa's labor and natural resource endowments are sufficient. However, the continent is still low in everything, low public capital (e.g., lack of energy, roads, railroads, and airports); low human capital (e.g., lack of trained, educated, and healthy labor force); and low institutional capital are all important (weak security and judicial systems, weak property rights, and poor regulatory and standards). The excellent quality of these capitals increases physical and financial capital productivity while lowering the cost of doing business. When investors provide these directly, they act as levies on investment returns. These things are supposed to be figured out as a return by foreign investors.

And lastly, there are three ways to describe the relationship between FDI and employment (Jude & Silaghi, 2016) . The first is when FDI directly creates new jobs in host nations, with the impact being greater when foreign investments are directed to labor-intensive industries. Second is rivalry and spillover effects explain the second channel of FDI employment consequences, and finally, competition pushes out indigenous enterprises, causing foreign firms to seek more labor after gaining a large market share, resulting in higher employment. Despite many governments' efforts to enhance the economic well-being of the youth through FDI and other means, youth unemployment has been on the rise in several nations throughout the world (United Nations 2013).

Therefore, dependency theory is relevant in elucidating the realm of the horn because of two rationales; poverty cum underdevelopment become perennial in Africa despite all efforts of FDI at curbing the menace and in spite of the huge human and material resources which Africa is endowed with, poverty cum underdevelopment has remained endemic leading to the current preposterous situation where Africa is dependent on foreign aid and humanitarian assistances to feed its teeming population.

In a nutshell, the fact that there is so little industry in Africa despite the impressive record of economic growth being posted by the continent, bad macroeconomic indicators, economic espionage, dependency on international economic players and so forth modalities clearly show that foreign direct investment in Africa creates venom than a nostrum; nonetheless, it does not mean FDI hardly brings fruitful advantages.

CONCLUSION

This study assessed the relevance of dependency theory in studying FDI in Africa. More particularly the theories of FDI: from macroeconomic indicators, decreasing trade openness, low infrastructure development, low level of return on capital and exchange rate, increment of inflation rate were used to assess the potency of these theories in explaining the realm of Africa. Accordingly, the study found out that the fact that there is so little industry in Africa despite the impressive record of economic growth being posted by the continent, bad macroeconomic indicators, economic espionage, dependency on international economic players and so forth modalities clearly show that foreign direct investment in Africa creates venom than a nostrum; nonetheless, it does not mean FDI hardly brings fruitful advantages. Thus, dependency theory possesses the ability to tell why and how FDI relationships lead to disparity of economic wealth.

This paper concluded that it is a folly to infer, as classical theorists, that foreign investment is wholly beneficial to the host state while the other (dependency theory) maintains that a host state cannot achieve development unless it turns away from dependence on foreign investment. The conflicting economic theories had a definite impact on the articulation of the legal principles, and it is necessary to understand these theories.

However, the power of dependency theory rests on the facts that poverty cum underdevelopment become perennial in Africa despite all efforts of FDI at curbing the menace and in spite of the huge human and material resources which Africa is endowed with, poverty cum underdevelopment has remained endemic leading to the current preposterous situation where Africa is dependent on foreign aid and humanitarian assistances to feed its teeming population.

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