

FDI Determinants, Is Africa Different?

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Abstract

In this paper we plan to focus on the FDI determinates in Africa, particularly in three African counties namely, Ghana, Nigeria, and South Africa, utilizing the regression analysis and Granger causality test with sample period compass from 1960 to 2011, we found that the determinants are not the same as country to country, case in point, in Ghana Infrastructure, Labor Force, and Exchange Rate are the key elements in pulling in the FDI, while Infrastructure, and the openness variables are assuming exceptionally critical part in drawing in the FDI in Nigeria, likewise we found Exchange Rate gives off an impression of being the primary component in attracting the FDI in South Africa. Concerning causal relationship between the determinants and the FDI, we discovered unidirectional causal relationship runs from the determinants to the FDI in all countries.

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1/ Introduction

Foreign Direct Investment (FDI), can be considered as the key element in Africa's economic development attempts, through supplementing domestic savings, increasing employment rate, transferring new technologies, and enhancing skills of the local manpower (Dupasquier and Osakwe (2003); Anyanwu (2006)).

In the last few decades FDI has made rapid increases, in 1980 the worldwide FDI inflows was Us\$54.1 billion rose to Us\$207.7 billion in 1990, then to a top of Us\$1,401.5 billion in 2000. By 2003 FDI had dipped to Us\$565.7 billion preceding topping again at Us\$2100 billion in 2007. Estimates for 2009 put the tumble to Us\$1114.2 billion ensuing upon the financial and economic crisis. In 2012 FDI fell to \$1.35 trillion. After the 2012 slump cautious optimism returns to global foreign direct investment (FDI) with inflows rising 9 per cent in 2013, to \$1.45 trillion UNCTAD projects that FDI flows could rise to \$1.6 trillion in 2014, \$1.7 trillion in 2015 and \$1.8 trillion in 2016, with relatively larger increases in developed countries³.

However, Africa has never been a genuine beneficiary of FDI streams, accordingly waits behind other regions of the world. On a yearly typical basis, Africa received 2.6 percent of overall FDI inflows during the period 1980 – 1989, however the FDI decreased to 1.9 percent in the period 1990 – 1999, and increased again by 3.2 percent in the period 2000 – 2009, in 2013 African FDI reached 3.9 percent of the total worldwide FDI. In the midst

³ UNCTAD conferences proceedings different issues.

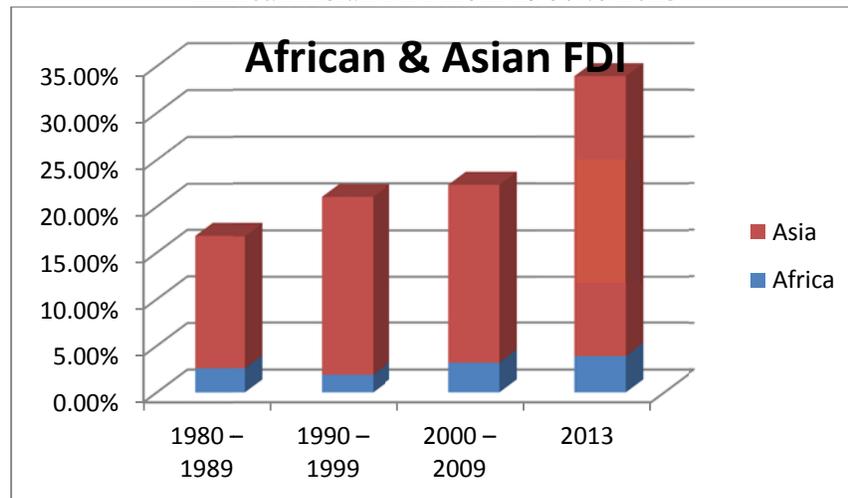
of the same periods, the Asian area got FDI inflows 14.2 percent, 19.1 percent, 19.1 percent, and 30% of total overall inflows, respectively. One key question is: Why does Africa not attract much FDI? The answer to this question is important to Economic and political policy makers, investment companies economics, and individual investors in the Continent and hence calls for further analysis of the forces driving FDI.

Figure (1)
Worldwide FDI from 1980 to 2016



Source: UNCTAD conferences proceedings different issues.

Figure (2)
African Asian FDI from 1980 to 2013



Source: UNCTAD conferences proceedings different issues.

In this study, we are going to investigate the determinates of FDI in three African countries namely, Ghana, Nigeria, and South Africa, those countries have developed many incentives to attract more FDI, for instance, to empower the inflow of FDI into the country, Ghana received numerous programs during the time, for example, the usage of the Pioneer and Companies Act of 1959, emulated by the Capital investment Demonstration of 1963, then the 1973 investment Order and the 1975 investment Arrangement Order NRCD 329, after the 1981 investment Code (Act 437) lastly the 1985 investment Code (PNDCL 116). It additionally presented motivating forces, for example, tax holidays, quickened depreciation allowances, exemption for import duties on machinery and equipment, venture remittances, and arrangements for profit repatriation (Asante, 2006). The country did not stop there, it executed the liberalization of the monetary framework and the Free Zones Plan.

To attract FDI, Nigeria has adopted motivations and programs such as “the abolition of the import licensing system, diminishment and change of import obligations and tariffs, privatization of state-possessed endeavors, and the presentation of the second level of foreign exchange market. Those motivations were altogether gives and credits at concessional interest rates, decreased tax rates, sponsored infrastructure or services (Ogunkola and Jerome, 2006).

South Africa has pulled in FDI with its rich show of mineral resources, political dependability and opportunity, good infrastructure facilities, high yearly rate of degree of profitability, low corruption level, business sector size, work profit, developing investment and rights to passage and foundation. Nonetheless, South Africa has

numerous drawbacks, for example, exchange rate risk, instabilities and the moderate pace of privatization which has been bringing down the inflow of FDI into the country (Akinboade et al, 2006).

There are numerous theories which endeavor to clarify the determinants of FDI. Dunning, (1993) portrays three types of FDI focused around the thought process behind the investment from the point of view of the investing firm. Market seeking is the first sort of FDI, which is interested in serving the nearby and regional markets, therefore market size and market growth of the host economy assume essential parts in attracting FDI. The second sort of FDI is called resource seeking FDI, happens when firms invest abroad to acquire resources not accessible in the country of origin, such as natural resources, raw materials, or low-cost labor. Accessibility of low-cost labor is a prime driver for this type of FDI. Regularly, FDI in the resource sector, for example, oil and gas, is pulled in to countries with ample natural endowments. The third kind of FDI, called efficiency-seeking, takes place when the firm can gain from the common governance of geographically dispersed activities in the presence of economies of scale and scope.

The findings of this paper demonstrate that the determinants of FDI in Africa vary from country to country, for instance, in Ghana Infrastructure, Labor Force, and Exchange Rate are the key components in attracting the FDI, while Infrastructure, and the openness variables are accepting particularly basic parts in attracting the FDI in Nigeria, similarly we found exchange rate gives off an impression of being the essential variable

in pulling in the FDI in South Africa. Concerning causal relationship between the determinants and the FDI, we found unidirectional causal relationship runs from the determinants to the FDI in all nations.

The paper is organized as follows, in the next section we will review the existing literature, the data and the methodology will be displayed in the third section, in the fourth section the empirical results will be discussed, finally in the last section summary and conclusion remarks will be revealed.

2/ Literature Review

The literature analyzes countless number of variables that have been put forward to clarify FDI. Some of these variables are incorporated in formal theories, though others are recommended on the grounds that they bode well naturally. Despite the underlying theory or the grouping of these variables, existing studies have considered distinctive consolidations of these variables with blended results, not just as for the significance of these variables but also for the direction of the effect.

Goldsbrough (1979), Saunders (1982), Flamm (1984), Schneider and Frey (1985), Culem (1988), and Shamsuddin (1994) exhibit that higher wages dishearten FDI. Kravis and Lipsey (1982), Culem (1988), Edwards (1990) discover a solid positive impact of openness on FDI, whereas, Schmitz and Bieri (1972) acquire a weak positive link.

Wheeler and Mody (1992) finds a positive linkage between openness and the manufacturing sector, however a frail negative connection in the electronic sector.

Edwards (1990) and Jaspersen et al. (2000) presume that GDP per capita is contrarily related with FDI, yet Schneider and Frey (1985), Tsai (1994) and Asiedu (2002) discover a positive relationship between the two variables. They contend that a higher GDP per capita intimates better prospects for FDI in the host country. Tsai (1994) acquires solid backing for the cheap-labor positive impact on FDI over the period 1983 to 1986, however feeble backing from 1975 to 1978. Erramilli and D'souza (1995) find that exchange rate volatility is one of the givers to outer vulnerability in an economy that have a real impact on FDI inflow.

A host country's economic instability could be a significant obstacle to FDI inflow and mutilate investor's recognition on the future profit in the country. Barrell and Torment (1996) find that investors have a tendency to put off their investment when the currency in the targeted market reinforces. Ahn et al. (1998) note blended opinion to expanding FDI by devaluating currency. In any case, they find that empirical research support a positive effect. As such, inflation might be utilized as a marker of the monetary and political state of the host country. Glaister and Atanasova (1998) In spite of the fact that they didn't attract immediate deductions to the relationship between FDI and inflation, they appear to propose that high inflation can result in different problems inside the country to decrease its appeal to foreign investors. Coskun (2001) recommends that lower

inflation and interest rate coupled with other variables, for example, full membership with the EU and high economic growth can draw in foreign investment and expand the FDI inflow into Turkey. Wint and Williams (2002) show that a stable economy pulls in more FDI, hence a low inflation is wanted in a country that push FDI as a wellspring of capital flow. Qin (2002) finds that if a low differential in purchasing power parity exists between trading countries, two-way FDI can happen. Also FDI would turn into an instrument for local producers to hedge their risk against a volatile exchange rate. Jordaan (2004) claims that good quality and well-developed infrastructure, larger and growing markets, a country's level of openness expands the profit capability of investments in a country and accordingly invigorates FDI streams towards the country. Akinboade et al (2006) express that low inflation is taken to be an indication of internal economic stability in the host country, whereas, high inflation demonstrates the powerlessness of the government to adjust its budget and the disappointment of the central bank to lead fitting monetary related arrangement. Pärletun (2008) finds that GDP, and trade openness are positively related with FDI but the relationship of openness was insignificant. Ang (2008) finds that real GDP has a significant positive impact on FDI inflows. He likewise finds that growth rate of GDP has a little positive effect on inward FDI. Kyereboah-Coleman and Agyire-Tettey (2008) find that volatility in exchange rate has a significantly negative effect on FDI inflow.

A few number of studies has been conducted to figure out the FDI determinants in Africa, In addition to different elements, labor cost, infrastructure, market size, trade openness, political stability, exchange rate, distance from major markets, human capital development, monetary policies, fiscal and other non-tax incentives and the legal system

are the main factors that can be used to attract the FDI (Khan and Bamou, 2006). (Tsikata et al. 2000) shows that trade regime, democratic governance, investment, economic uncertainty and raw material availability are determinants of FDI in Ghana, while Asante (2006) states that the determinants of FDI are openness of the host country, political risk, financial depth, government size and economic growth, natural resources, openness, inflation and exchange rate are revealed to be determinants of FDI inflow in Nigeria (Soumyananda, 2009). Wafure and Nurudeen (2010) state that market size, deregulation, political instability and exchange rate depreciation are the determinants of FDI. Niboi (2011) also found that trade openness and GDP per capita have a significant relationship with FDI in Ghana.

FDI has grown throughout the years and has had some incredible effects on the improvement and development of African countries development. However, lack of research papers on FDI determinants, and its impact on the economic growth in Africa creates a gap in the literature, in this paper we are going to fill this gap. Particularly, we examine FDI determinates in Nigeria, Ghana and South Africa which will help in understanding the essentialness of FDI in Africa and how it can help in the economic growth of those countries.

3/ Data and Methodology

The data of this study span from 1960 to 2011 were gathered from World Development Indicator database of the World Bank, IMF and UNCTAD. The statistical data utilized was restricted in view of the inaccessibility of data on unemployment and measure of

political instability which were required to show if and how the expand of capital investment lessen unemployment and if political precariousness has any impact on capital investment.

Variables Description

FDI (Foreign Direct Investment): represents the inflow of capital investment in the country.

GDP (Gross Domestic Product) growth: represents the economic growth of the country. It will be denominated in percentages. GDP growth per capita has been used as a determinant of FDI in many studies such as Nunnenkamp and Spatz (2004) and Tsai (1994).

Inflation: shows the rate of price change. It is represented as a GDP deflator in percentage.

Exchange rate: is the domestic currency price of a US Dollar.

Labor force: includes people aged from 15 years and older, both employed and unemployed.

Openness: is the sum of exports and imports divided by GDP.

Infrastructure: is represented by the total number of fixed telephones lines per 1000 people.

The point of this paper is to examine the Foreign Direct Investment (FDI) determinants in three African countries namely, Ghana, Nigeria, and South Africa. To do thus, firstly we

will utilize Equation (1) to measure the impact of inflation, real interest rate, labor force, openness to trade and infrastructure on the Foreign Direct investment through Equation 1:

$$FDI = \beta + \beta_1 GDP + \beta_2 INFL + \beta_3 ER + \beta_4 LF + \beta_5 OPEN + \beta_6 INFR + \varepsilon \quad (1)$$

Parameters:

- Dependent variable: FDI
- Independent or explanatory variables are:
 - o GDP: gross domestic product
 - o INFL: inflation as a percentage of GDP
 - o ER: exchange rate
 - o LF: labour force
 - o OPEN: openness to trade
 - o INFR: infrastructure

β is the intercept

$\beta_1, \beta_2, \beta_3, \beta_4, \beta_5, \beta_6$ are slopes and coefficients of the independent variables.

ε = error term

Secondly, to test for the relationship between the GDP as proxy of Economic Growth and the Foreign Direct investment we will use equation (2):

$$FDI = \beta + \beta_1 GDP + \varepsilon \quad (2)$$

Granger causality test advocated by Granger (1969) is the most common way to test for the causality between two variables X and Y. The method involves estimating the following equations:

$$Y_t = \beta_0 + \sum_{j=1}^J \beta_j Y_{t-j} + \sum_{k=1}^K \gamma_k X_{t-k} + u_t \quad (3)$$

$$X_t = \beta_0 + \sum_{j=1}^J \beta_j X_{t-j} + \sum_{k=1}^K \gamma_k Y_{t-k} + u_t \quad (4)$$

As an introductory analysis, unit root test is employed on the return data collected using Augmented Dickey-Fuller (ADF) test⁴. Our data was found to be non-stationary. In that case, the difference of series is taken until stationary condition is provided. The OLS (Ordinary Least Squares) regression method will be used to estimate the models.

4/ Empirical Results:

Table (1) shows in Ghana - GDP, INFL and OPEN are not relevant to explain FDI while INFR, LF and ER have a significant relationship with FDI at 1% level of significance and they are jointly relevant to explain FDI. Adj. R²= 0.72 it means that 72% of the variation in the dependent variable FDI is explained in the equation. Regarding Nigeria – GDP, INFL, LF and ER are not individually relevant while INFR and OPEN are individually significant at 5%, and 10% respectively, and they are jointly relevant to explain FDI. R²=

⁴ Results are available upon request.

0.50 which indicates that 50% of the variation in the dependent variable FDI is explained in the equation. For South Africa – the independent variables are not relevant to explain FDI with exception of ER at 10% level of significance, but they are all jointly relevant. $R^2 = 0.26$ signifies that 26% of the variation in the dependent variable FDI is explained in the equation.

Taking into account the results discovered and on the coefficients, trade openness has a positive association with FDI in Nigeria. This positive relationship is affirmed by different studies such as, Asiedu (2005), Hausmann and Fernandez-Arias (2000), Edwards (1990) and Soumyananda (2009) who classify trade openness as a significant determinant of FDI.

Ehimare (2011) expresses that inflation does not have any significant effect on FDI inflow in Nigeria which is same as our results in Ghana, Nigeria and South Africa; while Soumyananda (2008) discovered the ascent in inflation to increment FDI inflow subsequently FDI and inflation are decidedly related. This positive relationship is likewise upheld by Asiedu (2005). While, examine by Djokoto (2012) shows inflation to be negatively significant to FDI in Ghana.

The result for Ghana demonstrates the solid effect of labor force in pulling in FDI inflow, Wheeler and Mody (1992) and Olusegun et al. (2009) exhibited a positive relationship between labor force and FDI, which underpins the findings in Ghana. Notwithstanding,

the results of labor force in Nigeria and South Africa were found insignificant which is like the results of Loree and Guisinger (1995).

Exchange rate is positively related with FDI in Ghana and South Africa. Wafure and Nurudeen (2010) and Ehimare (2011) backing the positive relationship between Exchange rate and FDI. The positivity of Exchange rate is greatly vital to draw in FDI as an increment in Exchange rate in the host country will create a substantial inflow of FDI from foreigners.

Infrastructure has a significant relationship in Ghana and Nigeria which is interfaced to studies by Asiedu (2005) and Wheeler and Mody (1992) whose results show that great Infrastructure prompts more FDI inflows.

Table (1)
FDI determinants in Ghana, Nigeria, and south Africa

	GDP	INFL	INFRA	LF	OPEN	ER	Adj. R ²	F. test
Ghana	-0.024	0.004	2.733*	3.45*	-0.017	4.917*	72%	22.18*
Nigeria	0.031	0.011	3.166**	0.00001	0.043***	-0.016	50%	9.34*
S. Africa	0.0097	-0.0071	-0.0624	- 0.0001	0.009611	0.290***	26%	3.97*

*, **, *** indicate significant at 1%, 5%, and 10% level of significance respectively.
The table shows that, infrastructure, Labor Force, and exchange Rate are the determinants of FDI in Ghana, while Infrastructure, and Openness are the determinants of FDI in Nigeria, in South Africa the determinant is Exchange rate.

Table (2) reveals that, when eliminating the other variables and focusing only on GDP and FDI, we found no direct relationship between them in all countries with exception of Ghana at 10% level of significance.

The test gives that GDP has a positive however insignificant relationship with FDI in Nigeria and South Africa which is affirmed by Ilemona (2010) study on the effect of FDI on economic growth in Nigeria, where it was observed that FDI performs a part in Nigeria's economic growth. It is additionally underpinned by Loree and Guisinger (1995), Hausmann and Fernandez-Arias (2000) while Akinlo (2004) demonstrated that FDI has a positive relationship on Nigeria's growth, though Edwards (1992) exhibited that FDI and GDP have a negative relationship which repudiates our findings.

Table (2)

FDI and GDP relationship in Ghana, Nigeria, and South Africa

	GDP
Ghana	0.136***
Nigeria	0.030
South- Africa	0.057

*, **, *** indicate significant at 1%, 5%, and 10% level of significance respectively.

The table shows the is no direct relationship between FDI and GDP in all countries, the only exception was Ghana, at 10% level of significance.

Granger causality test

Tables (3, 4, and 5) show that there are three variables cause the FDI significantly at 5% level of significance in Ghana, namely ER, INFR, and LF, whereas in Nigeria OPEN and INFL cause the FDI, finally ER and LF cause FDI in South Africa.

Table (3)
Pairwise Granger Causality Tests in Ghana

Null Hypothesis:	F-Statistic	Prob.
GDP does not Granger Cause FDI	1.87936	0.1647
FDI does not Granger Cause GDP	1.40347	0.2565
OPEN does not Granger Cause FDI	1.57888	0.2177
FDI does not Granger Cause OPEN	0.96023	0.3907
INFL does not Granger Cause FDI	0.26695	0.7669
FDI does not Granger Cause INFL	0.25917	0.7729
ER does not Granger Cause FDI	6.60712	0.0031
FDI does not Granger Cause ER	18.7048	1.E-06
INFR does not Granger Cause FDI	4.62276	0.0151
FDI does not Granger Cause INFR	1.33668	0.2732
LF does not Granger Cause FDI	3.22279	0.0494
FDI does not Granger Cause LF	0.03378	0.9668

*, **, *** indicate significant at 1%, 5%, and 10% level of significance respectively.

The table shows that there are three variables cause the FDI significantly in Ghana, namely Exchange Rate, Infrastructure, and Labor Force.

Table (4)
Pairwise Granger Causality Tests in Nigeria

Null Hypothesis:	F-Statistic	Prob.
GDP does not Granger Cause FDI	1.05020	0.3585
FDI does not Granger Cause GDP	0.94337	0.3970
OPEN does not Granger Cause FDI	2.67152	0.0804
FDI does not Granger Cause OPEN	1.43063	0.2501
INFL does not Granger Cause FDI	7.52919	0.0015
FDI does not Granger Cause INFL	1.31447	0.2790
ER does not Granger Cause FDI	0.56334	0.5734
FDI does not Granger Cause ER	0.71594	0.4943
INFR does not Granger Cause FDI	1.85243	0.1689
FDI does not Granger Cause INFR	0.03317	0.9674
LF does not Granger Cause FDI	1.84582	0.1699
FDI does not Granger Cause LF	17.6891	2.E-06

*, **, *** indicate significant at 1%, 5%, and 10% level of significance respectively.

The table shows that there are two variables cause the FDI significantly in Nigeria, namely Openness, and Inflation.

Table (5)

Pairwise Granger Causality Tests in South Africa

Null Hypothesis:	F-Statistic	Prob.
GDP does not Granger Cause FDI	1.02675	0.3666
FDI does not Granger Cause GDP	0.55982	0.5753
OPEN does not Granger Cause FDI	1.27055	0.2908
FDI does not Granger Cause OPEN	1.55699	0.2222
INFL does not Granger Cause FDI	0.60447	0.5508
FDI does not Granger Cause INFL	0.22253	0.8014
ER does not Granger Cause FDI	4.89310	0.0121
FDI does not Granger Cause ER	24.2610	8.E-08
INFR does not Granger Cause FDI	1.53971	0.2258
FDI does not Granger Cause INFR	0.11116	0.8950
LF does not Granger Cause FDI	5.16179	0.0097
FDI does not Granger Cause LF	0.13484	0.8742

*, **, *** indicate significant at 1%, 5%, and 10% level of significance respectively.

The table shows that there are two variables cause the FDI significantly in South Africa, namely Exchange Rate, and Labor Force.

5/ Summary and Conclusion

In this paper we plan to focus on the FDI determinates in Africa, particularly in three African counties namely, Ghana, Nigeria, and South Africa, utilizing the regression analysis and sample period compass from 1960 to 2011, we found that the determinants are not the same as country to country, case in point, in Ghana Infrastructure, Labor force, and exchange rate are the key elements in pulling in the FDI, while Infrastructure, and the openness variables are assuming exceptionally critical part in drawing in the FDI

in Nigeria, likewise we found exchange rate gives off an impression of being the primary component in pulling in the FDI in South Africa. In measuring the impact of the FDI on the GDP as substitute of the economic growth, we found that there is no direct relationship between them in all countries, the main special case was Ghana. Concerning causal relationship between the determinants and the FDI, we discovered unidirectional causal relationship runs from the determinants to the FDI in all countries, in particular, infrastructure is causing the FDI in Ghana and Nigeria, while there is causal relationship runs from the exchange rate and labor force to FDI in Ghana and South Africa, the openness is causing the FDI just in Nigeria.

The findings stress the fact that, there are no basic variables could be considered as key players in pulling in the FDI in all countries in Africa, yet these variables are unique in relation from country to country, in this manner the policy makers at the African countries ought to focus on the principle figures that draw in the FDI in their countries.

These empirical findings have vital key arrangement suggestions for African countries. Initially, upgraded provincial participation and incorporation will likewise expand market size in Africa and help draw in investors at present obliged partially by the little size of some household African markets.

The results demonstrates that infrastructure is exceptionally imperative component in attracting the FDI, all else equal, a country with more infrastructure would be expected to draw in more FDI, in this manner policy makers particularly in the countries with poor

infrastructure expect to put resources into enhancing the household infrastructure. Nonetheless, for some reasons a country with poor infrastructure may be an alluring host for FDI, and even overwhelming interest in infrastructure won't be a grantee to pull in more FDI.

The findings additionally demonstrate the significance pretended by labor force in attracting the FDI to Africa, most African countries rely upon cheap labor force advantage –comparing with the develop countries to pull in more FDI, however by not enhancing the work compel in these countries their aggressiveness in drawing in FDI will be unfavorably influenced. the policy makers in these countries need to realize that the key point to enhance the capability of African countries to attract more FDI relies on expanding the human assets capacities through upgrading the advanced education, expert preparing to addition learning about the new innovations, since the future blasting commercial enterprises, for example, IT and biotechnology require high skilled labor force.

Trade openings has risen as one of the principle determinants of FDI in the African countries, however the impact of the trade openness is unique in relation to country to country focused around the inspiration of FDI exercises (Dunning1993). The policy makers in Africa ought to realize that trade openness influences emphatically on FDI through liberalization which expands specialization and division of the work hence enhancing benefit and fare ability and additionally economic performance.

The results likewise demonstrates, all else equal, the devaluation of domestic exchange rate ought to draw in more FDI as it enhances the rate of return to foreign companies, the policy makers in the African countries should know that the fruitful of this arrangement depend on various fundamentals, firstly exchange rate depreciation ought to be connected with change in the production cost and ought not be went with balancing increment in the real wages in the target market.

At long last, the results reveals that Inflation could be considered as a pointer of the monetary and political states of the host country, case in point low inflation is taken to be an indication of financial stability, though high inflation shows instability.

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