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Determinants of Foreign Direct Investment Flows to Francophone African Countries: Panel Data Analysis

Yapatake kossele Thales Pacific[1], *Riti Joshua Sunday[2], Anning Lucy[1]
1, School of Economics, Huazhong University of Science and Technology
1037 Luoyu Rd., Wuhan, China 430074
2, Department of Economics, Faculty of Social Sciences, University of Jos, Nigeria

Abstract
This paper used yearly secondary data from 25 African francophone countries covering the period 2004-2012 to examine the factors that deter or attract foreign direct investment (FDI). Strength of minority investor protection in the country, the time required to start a business in terms of days from Doing Business Website are introduced in the model. We use 6 empirical determinants of FDI such as the growth rate of Gross Domestic Product, exports in goods and services, official exchange rate, domestic credit to private sectors, *information and communications technology defined by the number of internet users,* political stability and absence of violence. A Hausman test was performed and the results from the test suggested the use of fixed effect model. The results from regression with time and country fixed effects show that export in goods and services, internet's users, official exchange rate, political stability and absence of violence estimate, the time required to start business in the country have greater influence on FDI. Development of the private sector can contribute to take up this challenge of attractiveness of FDI. It is very important for Francophone countries to encourage the development of sustainable private enterprises by granting of credits.
Keywords: FDI**,** Time fixed effects, Countries fixed effects, Francophone African countries

I. Introduction.

The wonderful aspect of development in global business is realized by foreign direct investment which gives new opportunities such as low cost of production, technology, and financing. Foreign direct investment (FDI) in Africa have increased by 4% representing a total of $ 57 billion in 2013, which can be explained by international and regional investments which take advantage of new opportunities as well as by investments in infrastructure, according to the world Investment Report 2014. Theoretical studies reveal that Foreign Direct Investment (FDI) has a positive impact on the growth in GDP of the host-country even if some countries are trying to attract FDI by following outward-oriented industrialization policies in order to increase the growth of economy (Yılmazer, 2010:242). By looking at the average of GDP in African countries, Francophone countries account for only 19 percent of the average GDP of Subs-Saharan Africa while the Anglophone countries boast 47 percent (excluding South Africa). African countries which use French language, predominantly located in West Africa grew at an average rate of 3.4 percent per year over the last ten years, while those predominantly Anglophone East Africa community (EAC) recorded a growth rate of 5.4 percent (Jeune Afrique news, 2012) , which reflected that the volume of FDI that flows to Francophone countries is very low to influence GDP, despite efforts made by local governments to attract FDI through setting up policy frameworks and economic regional integration in Africa. The study conducted by Nadeem Iqbal et al (2013) on impact of foreign direct investment (FDI) on GDP: A Case study of Pakistan using the function of cob-Douglas found that there is a positive relationship between FDI and GDP in Pakistan. Another research made by Lim GuechHeang and Pahlaj Moolio (2013) found also that FDI positively affects GDP by generating employment and in the long run contributes to poverty reduction . It can be argued that the low percentage of GDP reflects the country economy situation such as: slow growth, lower technology, and low amount of domestic savings, political instability, lower degree of openness, lower bureaucratic management, lower treaties and guarantees etc.The aim of this paper is to examine the factors that attract or deter FDI using panel data, and further identify and recommend policies which can increase FDI inflows. The paper is organised as follows: following the introduction in section I is the literature review in section II. Data hypothesis and econometric model occupies section III. Section IV examines the results and discussions while section V concludes the study with policy recommendations.

II Review of Related Literature

Buckley and Casson(1985) define foreign direct investment (FDI) as a term used to denote the acquisition abroad of physical assets, such as plant and equipment, with operational control ultimately residing with the parent company in the home country. FDI may take different forms such as the establishment of new enterprises in an overseas country either as a subsidiary or branch, the expansion of overseas branch or subsidiary and the acquisition of overseas business enterprise or its assets. FDI differs from foreign portfolio investment where a stake is taken in an overseas business without operational control, but with the view to acquiring an investment income stream through dividends, capital gains and so on. FDI is furthermore, defined as a situation where a

foreign company create a subsidiary to provide goods and services. Thus a firm undertakes FDI in a foreign market if it possessed an ownership advantage over the local competitors. The ownership of personnel the foreign investment usually remains in the investing (home) country. FDI represents the primary means of transfer of private capital (i.e. physical or financial), technology and access to the brand names and marketing advantage.

FDI is believed to begin in the late nineteenth century. The Victorian and Edwardian eras saw the creation of many of the great vertically integrated multinationals that would be recognized today as colonial plantation companies such as Lever Brothers (now Unilever) investing in West African vegetable Oil plantations, Cadbury's in Cocoa, Dunlop in rubber. The UK as the great imperial power of the time, dominated world international business with over 45% of the world's total stock of the FDI in 1914. Following the World II, the FDI leadership passed over to the US, with companies such as General Motors, Ford Chrysler, and IBM, developing manufacturing bases around the world. By 1960, US counted over 48% of the world investment. However; the significant entrant in international scene has been Japan.

In 1960, Japanese firms accounted for less than 1% of the world accumulated FDI. By 1989, the Japanese share was over 12%, against 29.5% for the US and 15% for the UK in 1990s there was a significant change in the trend of FDI. This is because FDI started flowing to the developing countries surged to 30%-40% compared with just15% and 18% in 1980s. However, the majority of the FDI went to countries of the Asia-Pacific region. Major countries namely the US, UK, and Japan, accounted for this bulk outward investment (Buckley and Casson, 1985).

A number of researchers have conducted studies on FDI in Africa. They include Avom Desire and Ongo and Avom (2013), Felix and Zu (2009), but there is a lack of studies on the determinants of foreign direct investment in Francophone African countries. The market size was looking long time as of the determinants of FDI. The market size and growth were discussed by lot of researchers such as Yasin et al (2005), Benbe-Nahende (2002), Fedderke and Romm (2006). An economy with the big market size normally should attract more foreign direct investment and the countries that have high and sustained macroeconomics variables seek to receive higher amounts of FDI than volatile economies. Elbadawi and (1997) argued that the countries which have market size or natural resources will attract more FDI. He found also that the labor force, the good infrastructure quality, political stability and low corruption level have greater influence on FDI. Another research conducted by Bhinda et al. (1999) on private capital flows perception and reality state that the inadequate market is the important factor that deters for the firms which want to invest in the domestic market. The study conducted by Jordaan (2004) found that the countries with the big market size and good purchasing power will have the chance to attract more FDI due to higher return of the capital and profit of firms. Artige and Nicolini (2005) argued that the GDP per capita or the GDP seems to be the most robust FDI determinant in econometric studies. According to Morisset (2000) the natural resources and the local market are not the only point which can attract FDI. African countries need to improve their business climate and promote those policies which are significant in the improvement of their economic growth. Lemi and Asefa (2003) made their research on the link between economic and political uncertainty and FDI flows in Africa. The result of the panel study for 29 countries over the period of 1987-1999, found that political uncertainty affects FDI in Africa using generalized autoregressive heteroscedastic model to generate economic uncertainty. Onyeiwu and Shrestha (2004) by using fixed and random effects for 29 African countries over the period 1975 to 1999 found that: international reserves, economic growth, and openness of the economy, natural resource availability and inflation have greater influence on FDI. N'guessan et al (2010) by examining the long-run impact of FDI and trade openness on economic growth found that openness is significant in explaining output growth in Ivory Coast. The importance of openness on attracting FDI has been confirmed in many previous studies, Cuadros and Alguacil (2001); Eric, N (2005); Yan (2012); Baharom et al (2008); Zaheer et al (2011) advocated that liberal trade policies encourage FDI. Institutional quality and FDI in Nigeria for Ntim and Emilia (2013) results show that the level of FDI inflows is significantly related to the quality of institutions. Asiedu (2002) argued that foreign investors prefer countries with good infrastructure such as: transportation, communication and distribution of goods and services. A Lot of studies were conducted by many scholars about corruption. For instance Ali al-Sadig (2014) on the effects of corruption on FDI inflows by incorporating an econometric method based on the panel data from 117 countries over the period 1984-2004 found that the corruption level in the host country has an adverse effect on FDI inflows. Svetlana (2014) found that the perceptions of corruption and fiscal policy are some of the more important drivers of FDI attraction. Dar, Presley and Malik (2004) studied the causality and long-term relationship between Foreign Direct Investment (FDI), economic growth and other socio-political determinants. By considering the determinants of FDI in Pakistan over the period of 1970-2002, found that almost all variables have the theoretically expected signs with two way causality relationship. Alfaro (2003) found that the inflows of FDI to economic sectors especially in manufacturing and services exert different effects on economy growth. A study conducted by Anyanwu (2012) on the determinants of FDI in an article entitled "Why Does Foreign Direct Investment Goes: New Evidence from African Countries." Covering the period of 1996 to 2008 found that the

rate of GDP growth have a positive impact on the attractiveness of FDI, Higher the growth rate, higher the volume of FDI inflows. The study conducted by Hubert and Phanindra (2004) on: Determinants of foreign direct investment: empirical evidence from EU accession

Candidates found that the openness to trade, the size of the host economy, host country risk, labour costs in host country is significant in attraction of FDI. In terms of Physical infrastructure Loree and Guisinger (1995) argued that the country with more developed infrastructure attract more FDI. Khan and Bamou (2006) found a significant impact of infrastructure in the attraction of FDI in Cameroon by using the ratio of paved road and electricity as measure of the determinants of FDI in Cameroon. Bissoon (2012) on the impact of institutional quality on the attractiveness of FDI found that the political stability and the control of corruption have a positive impact and significant impact on the FDI attractiveness. Bedia F.Aka (2007) impact of public and private investment on Cote d'Ivoire economic performance over the period 1969-2001 found that in short run an increase in private investment by one percent leads to an increase of economic growth of 28 per cent and he also found in short run the efficiency pubic capital can be improved in the country the efficiency of private investment can be improved in the long run. The relationship between political instability and FDI is unclear. The studies conducted by Hausmann and Fernandez-Arias (2000), Jaspersen et al. (2000) found no relationship between FDI flows and political uncertainty while Schneider and Frey (1985) on the Economic and Political Determinants of Foreign Direct Investment found an inverse relationship between FDI and political risk. Loree and Guisinger (1995) by using the data of United States FDI two time periods (1982 and 1977) found that political risk have a had a negative impact of FDDI in 1982 but no effect in 1997. Another research made by Edwards (1990) by using the political instability and political violence as measure of political risk found the political instability variable is significant while political violence is not significant. The importance of exchange rate on FDI has been examined in many studies both in bilateral level between countries and volatility. Klein and Rosengren (1994) found that depreciation increases US FDI. Kyereboah-Coleman and Agyire-Tettey (2008) on the on the volatility of real exchange rate in Ghana found that exchange rate has a negative impact on FDI inflow while (Jeon and Rhee, 2008) found FDI have a significant association with exchange rate and expected exchange rate. Another study conducted by Brahmasrene and Jiranyakul (2001) found no statically significant relationship between the FDI inflows and the exchange rate. The research conducted by Nasser and Gomez (2009) in 15 Latin countries covering the period of 1978 to 2003 shows that the FDI inflows have positive correlation with the stock market and the level of private credit offered by the banking sector. Jenkins and Thomas (2002) and Kinda (2010), Deichmann et al. (2003) found financial development encourages FDI inflows.

III. Data, Hypotheses and Econometric Model.

This part covers the methodological works relating to this paper. The study uses panel data analysis across 25 countries. We collect data for FDI inflows, growth rate of GDP, exports of goods and services, ICT in terms of internet users, domestic credit to the private sector, exchange rate and political stability and absence of violence for all countries in the study from the World Bank website. Data for Strength to protect investors and time required to start a business was collected from doing business website. We develop an eclectic model to investigate the determinants of FDI in Francophone African countries using theoretical and empirical literature review. The growth rate (GR) is important determinant of FDI, Erdal et al (2008); Khondoker (2007). In addition the exports in goods and services (EGS), Jaime (2010) found a positive (Granger) causality relationship from FDI to exports of goods and services to exports in the long run and in the short run affected positively by FDIs. There are several factors which come into play in what determines a country's attractiveness to FDI, there is growing literature on the role of information and communications technology (ICT) as a determinant of such investment. Basically the evidence suggests that ICT encourages FDI either by reducing search time and related costs or through increases in efficiency and productivity. The study conducted by Azmat and Basu (2003) found ICT and the diffusion of new ICT instruments (e.g. Internet hosts, mobile phones) are found to be significant factors for FDI. Another research made by Changkyu, (2003), reported a direct correlation between the growth of Internet users or Internet hosts and FDI. This works by to lower prices by reducing search costs for Business-to-business, business-to-consumer Business-to-government and generally contributing to the efficient functioning of both domestic and export markets. Besides internet users, the growth rate, the exports in goods and services, the domestic credit to privates sectors (DC) also appear to be important factors in attracting foreign investment. The study conducted by Hossein et al (2011) on local Banks Credits to Private Sector and Domestic Direct Investments effects on FDI Inflow in Malaysia found that domestic credit to the private sector and domestic direct investment respectively are cointegrated and granger caused foreign direct investment .Exchange rates (ER), defined as the domestic currency price of a foreign currency, matter both in terms of their levels and their volatility and they can influence both the total amount of foreign direct investment that takes place and the allocation of this investment spending across a range of countries. (S. Goldberg, Encyclopedia of the World Economy, Princeton University Press). The proponents of political stability and absence of violence (PSAV) estimate have long looked upon it as one of the determinants of foreign direct investment in Africa. The research

of Kim (2010) on Political Stability and Foreign Direct Investment has shown us: Countries high level of corruption and low level of democracy have higher FDI inflows. This means that FDI inward performance has consistently positive relationships with the level of corruption in a country. We are looking for a positive relation of political stability estimate on FDI inflows in francophone African countries. We selected two variables from Doing Business website to measures the strength of protecting investors (SP) and the time required to start business (TRSB) in terms of days as the bureaucratic quality expected to have a positive relationship on FDI. Based on the above discussions we develop the following baseline model:

$FDI_t = \beta_0 + GR_{it} + \beta_2 EGS_{it} + ICT_{it} + \beta_5 DC_{it} + \beta_6 ER_{it} + \beta_7 PSAV_{it} + \beta_9 SP_{it} + \beta_9 TRSB_{it}$……(1)

Where:

i and *t* represent the countries and the time.

FDI = the value of FDI inflows measured in Million USD.

GR = the growth rate of GDP.

EGS = the exports in goods and services.

ICT= the internet's users (per 100 people).

DC= domestic credit to private sector.

ER= exchange rate.

PSAV= political stability and absence of violence rating from -2.5 to 2.5.

SP= the strength to protect investors.

TRSB= the time required to start business in terms of days.

IV. Results and Discussion.

Table 1: Unit Root Test

	At Level		First Difference	
Variables	T -stat	Prob	T -stat	Prob
DC	-0.34608	0.3646	-3.99502	0.0000***
EGS	-5.14988	0.0000***	-12.4013	0.0000***
GR	-7.07108	0.0000***	-11.6600	0.0000***
ICT(2)	0.64700	0.7412	-7.96232	0.0000***
ER	-3.70762	0.0001**	-7.52956	0.0000***
PSAV	-4.64355	0.0000***	-1.86516	0.0311**
SP	2.07760	0.9811	-1.37011	0.0853*
TRSB	-1.89491	0.0291**	-1.60689	0.0540**
FDI	-4.91187	0.0000***	-5.04526	0.0000***

****, **, * indicates rejection of the null hypothesis of Unit Root Test at 1%, 5% and 10% levels of significance*

Source: Author's computationtion from Eviews 8.1

Table 1 presents the results of the preliminary time series test of unit root to avoid spurious regression. We can see that at the level, export in goods and services, growth of GDP, official exchange rate, political stability, time required to start business in the country, and the dependent variable (FDI) are stationary at level of 1% and 5%. On the other hand, domestic credits to private sector, strength to protect investors are not stationary at levels, but they became stationary at first difference of 1%, 5% and 10% significant levels. However only internet user (ITC) is integrated of order two, I (2). We conclude that the results of unit root test reported in table 1 support the hypothesis of a panel unit root in some variables across the countries, as well as the hypothesis of zero order integration in first differences.

Table 2: Panel data estimates: fixed effects (25 countries x 9 years (2004-2012), Dependent Variable, Foreign Direct Investment (FDI).

Variables	Time Fixed effects	Country Fixed effects	Fixed model
	0.93	0.862	0.43
GR	(-0.08)	(-0.17)	(0.77)
	0.0006***	0.0008***	0.23
EGS	(3.50)	(3.40)	(1.18)
	0.0000***	0.0001***	0.85
ICT	(4.78)	(3.89)	(-0.18)
	0.398	0.256	0.38
DC	(0.84)	(1.14)	(0.86)
	0.0001***	0.0016***	0.0002***
ER	(3.99)	(3.20)	(3.86)
	0.07*	0.0849***	0.44
PSAV	(-1.77)	(-1.73)	(0.75)
	0.409	0.459	0.88
SP	(0.82)	(0.74)	(-0.14)
	0.011***	0.011***	0.076*
TRSB	(2.54)	(2.54)	(-1.78)
	0.02***	0.039**	0.82
Constant	(-2.31)	(-2.07)	(0.21)
COUNTRIES EFFECTS?	**-**	**NO**	
TIME EFFECTS ?	**YES**	-	
R^2	**0.32**	**0.32**	**0.83**

Hausman test: Prob>Chi2 :0.0000

Source: Author's computation from Eviews 8.1.

****, **: * Significance at 1%, 5% and 10% the robust z in parentheses.*

The model specified is estimated using yearly secondary data from 2004-2012. In total we have 158 panel observations (e.g., 9 years x 25 countries x 8 variables for each year). The source of data is World Bank and Doing Business website. We have used the time fixed and the countries fixed effects in order to have a good understanding of fixed effects. Our findings are summarized in table 2. To decide between fixed or random effects a Hausman test was done where the null hypothesis was that the preferred model is fixed effects. By testing the time fixed and countries fixed effects we found that the independent variables such as: export in goods and services, the official exchange rate, political stability and absence of violence estimate and the time required to start a business are significant respectively at 1%, 5% and 10%: the values of their probabilities: 0.0006, 0.0001, 0.07, 0.011 and 0.0008, 0.0001, 0.0016, 0.08, 0.011 respectively which are lower than the 1%, 5% and 10% significance level. The significance of exchange rate can be explained by the parity between the CFA franc and the Euro which guarantees the stability of the currency and could contribute to the attractiveness of FDI in these countries. It should be noted that direct intra-regional investments are becoming increasingly important, particularly from North Africa to sub-Saharan countries (e.g. the Moroccan bank Attijari which is widely implemented in 10 Francophone countries). The exports in goods and services are significant for time fixed and country fixed effects at 1% (0.0006 and 0.0008 < 0.01). Oil, gold, aluminum and cotton are the main raw materials exported by the Francophone African countries. The increase in prices of raw materials contributed to increasing the volume and export revenue. The variable internet users is also significant for time effects and countries effects (0.0000 and 0.0001) due to a lot of reforms made in information and communications technology during the last decades. The political stability and absence of violence (PSAV) is statically significant at 10% level of significance. The Probability in the time and country fixed effect regression is (0.07 and 0.08) which is lower than 10%. The t-statistic indicates that the PSAV have a negative relationship with the FDI which can be explained by Francophone countries are most affected by the change of power conducted by force (45 coups out of the 74 made in Africa) over the period of independence until the year 2009. The domestic credit to private sector is not significant for time and countries effects despite the increasing in the intra-regional investments. By examining the credit to domestic private sector in Africa, banks granting loans to government, but no repayment of loan made on time as scheduled. This creates bank's shortfall or liquidity problems at banks. The best orientation to grant the credit policy is to create an activity that generates income. If the banks cannot meet all the requests, the state must help them by creating such a public investment to consolidate private initiatives. The time required to start business in the country have also greater influence on the FDI which can be explained by some policies set up by countries during this time in the domain of

bureaucracy. The domestic credit, growth, the strength to protect investors is not significant for time fixed effects and can be explained by the short time of study and financial crisis of 2007-2008 which have a negative effect on the growth rate and also because of the low amount of FDI that flows to Francophone countries. The strength to protect investors is not significant because the political instability in the country reflected the impotence of the government to protect investors. It is noticed that during the political crises, coups, revolutions, citizens from francophone African countries tend to destroy infrastructures and foreign companies which really prove that the strength to protect investors in this kind of countries is very low. It is very important for francophone countries to improve their business climate by maintaining in the long run the political stability and absence of violence by collective consciousness. Political instability affects FDI negatively, because they reduce the profitability for investors. Countries fixed effects is not significant, proved that there are not difference between francophone African countries, the reference of the developing countries with the same problems such as: infrastructure, electricity, level of corruption etc.

V. Conclusion and Policy Implications.

Foreign direct investment has the potential to act as a reliable and equitable factor of sustained economic development and poverty alleviation. In this paper we investigate, whether the growth rate of GDP, export in goods and services, the official exchange rate, and domestic credit to private sectors, information and communications technology defined by the number of internet users, political stability and absence of violence, affect FDI. It is based on a sample of 25 countries over the 2004-2012 periods. Using panel data, results from analysis shows that export in goods and services, internet's users, exchange rate, political stability and absence of violence estimate, the time required to start a business in the country are important factors which attract FDI Francophone African countries. Despite the efforts of African governments to attract FDI by improving their business environment and despite renewed activities in Africa, Francophone African countries FDI inflows remain low. Authorities must to continue fight against corruption and reduce inflation, develop mechanisms to enhance the credibility of Africa continent especially Francophone countries, construction of roads to facilitate transactions and stimulate transport, increase the production of electricity in order to maintain the long run sustainability of FDI, and encourage private investment by granting credits, create political stability atmosphere, absence of violence and terrorism to attract FDI.

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