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IMPACT OF FOREIGN DIRECT INVESTMENT INFLOWS ON ECONOMIC GROWTH IN SUB-SAHARA AFRICA

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Abstract

As the global economy becomes more interconnected, foreign direct investment (FDI) has become prevalent in nearly every country. A notable trend is the concentration of FDI inflows towards developing nations, driven by emerging opportunities and substantial market potential. Nonetheless, there are ongoing debates surround the actual impact of FDI on the economies of developing countries. Therefore, this study examined the impact of foreign direct investment on economic performances in sub-Saharan Africa using panel autoregressive distributed lag techniques from 2000 to 2022. The findings of the study revealed that FDI increases economic growth and inflation rate in Sub-Saharan African countries. Moreover, the coefficient of the error correction model was negative and significant indicating that the short-run disequilibrium is corrected in the long-run. Given the significant role of foreign direct investment inflows in influencing growth in sub-Saharan Africa, it is recommended that SSA countries should invest in renewable energy as well as technologies so as to attract more FDI.

Keywords: Foreign direct investment, economic growth, sub-Saharan African, panel ARDL
JEL Classification Codes: F21, 055, 047, F43, C23

1. Introduction

Economic growth in sub-Saharan Africa has been marked by a mix of progress and persistent challenges. While the region has experienced periods of growth, it continues to face obstacles that hinder sustainable development. The World Bank notes that while sub-Saharan Africa's GDP growth is projected at around 3.4% in 2024, challenges such as high debt levels, inflation, and poor infrastructure persist. Addressing these challenges is essential for achieving sustainable and inclusive growth (World Bank, 2024). The IMF similarly highlights that sub-Saharan Africa's growth is constrained by factors such as tight financing, weak governance, and limited fiscal space, making it difficult for the region to close the gap with other global economies (International Monetary Fund, 2024). More so, the primary challenges is the heavy dependence on commodity exports, leaving economies vulnerable to price fluctuations

and external shocks (Adam & Simpasa, 2016). For instance, countries like Nigeria, Angola, and Zambia heavily rely on oil, which exposes them to volatility in global oil prices. This reliance limits diversification efforts and undermines long-term growth prospects (IMF. (2019).

To address these challenges, policymakers in the region have implemented various policy interventions aimed at promoting economic diversification and resilience. Infrastructure development has been a key focus, with initiatives like the New Partnership for Africa's Development (NEPAD) and the African Development Bank's investments in transportation, energy, and telecommunications networks (NEPAD. 2001). These efforts aim to improve connectivity, reduce transportation costs, and enhance trade within the region, thereby boosting economic growth (African Development Bank, 2020). Additionally, regional integration initiatives such as the African Continental Free Trade Area (AfCFTA) seek to create a single market for goods and services, promoting intra-African trade and reducing dependency on external markets (African Union, 2018).

However, despite these interventions, sub-Saharan Africa continues do face significant challenges that hamper its growth potential. Poor governance, corruption, and weak institutions remain pervasive issues that undermine investor confidence and hinder economic development (Transparency International, 2021). Additionally, limited access to finance, especially for small and medium-sized enterprises (SMEs), constrains entrepreneurship and innovation (World Bank, 2018). Addressing these challenges requires a multi-faceted approach that combines policy reforms with targeted investments in human capital development, institutional capacity building, and the promotion of a conducive business environment (World Economic Forum, 2019). Moreover, greater coordination among governments, international organizations, and the private sector is essential to effectively tackle these complex issues and foster sustainable economic growth in the region (United Nations, 2020).

Due to imbalanced macroeconomic performance, sub-Saharan Africa has experienced disappointing economic performance over the past two decades, marked by challenges like low or negative per capita income growth, high inflation, rising unemployment, and balance of payments difficulties. The economic growth rate in SSA slowed to 3.6 per cent in 2023 from 3.9 per cent in 2022 relative to 4.1 per cent in 2021 (International Monetary Fund, 2024). Economic growth in SSA is not uniform across sub-regions and countries. The region's performance remains sluggish, dampened by

slower secular growth in the continent's largest countries. Economic activity in South Africa dropped to 2.0 per cent in 2022 from 4.9 per cent in 2021 as the energy crisis deepens, while Nigeria's growth recovery (2.74 per cent) remains fragile in 2023 as oil production continues to be subdued. Among the ten largest economies in SSA, generating more than three quarters of the region's GDP, eight of these are growing at rates below their long-term average growth, including Sudan, Nigeria, Angola and Ethiopia (World Bank, 2023).

One of the most crucial methods for fostering economic expansion and development in developing nations is a foreign direct investment. Theophilus (2019) had opined that the process by which individuals in one country acquire ownership of assets to gain control over the production, distribution, and other activities of a firm in a foreign country is referred to as foreign direct investment (FDI). They continued by defining FDI operationally as the possession of at least 10 per cent of the voting common stock in a foreign enterprise. Thus, the threshold for a direct investment relationship to exist is 10 per cent ownership of ordinary shares. Damian and Samuel (2019) define foreign direct investment (FDI) as an investment aimed at establishing control over a domestic company by a foreign entity. This type of investment is often associated with not only capital inflow but also technology transfer, management expertise, and access to international markets, which can significantly influence the economic landscape of the host country. It is one of the main sources of capital inflows to developing countries, from resource-rich countries and among developing countries themselves, and it has been widely recognized as being crucial for contributing to growth in productivity. The impact of foreign direct investment (FDI) on the economic sectors of less developed countries (LDCs) like those in Sub-Saharan Africa has been widely studied but remains a topic of debate. On one hand, FDI can promote economic growth by transferring technology, enhancing productivity, and creating jobs. This positive effect is particularly seen when investment flows target sectors like telecommunications, finance, and manufacturing rather than just natural resources. However, the benefits often depend on the host country's economic environment, including infrastructure and governance quality, which can limit FDI's impact on sustainable growth if inadequate (World Bank, 2020; World Economic Forum, 2022).

Various studies provide evidence supporting the theoretical arguments regarding the positive and significant influence of FDI on economic growth such as Emel & Ilyas (2022), Al-Muizzuddin (2024), Doan (2024).

In contrast, Bregougui (2023) examined the impact of FDI on the overall growth, as well as its sector-specific spillovers in the Middle Eastern and North African region for the period 2000 to 2020. On the flip side, Francis, Ebimowei & Peres (2024) presented findings indicating a non-significant impact of FDI on economic growth. It is in this context that the present study is considered worthy as it represents a conscientious effort to determine the extent to which FDI inflow impacts on economies in SSA countries.

2. Empirical Issues

Asafo-Agyei and Kodongo (2022) examine the effects of foreign direct investment (FDI), and the mediating role of FDI absorptive capacity, on economic growth in Sub-Saharan Africa. The study revealed that there is a threshold level of FDI inflows per person. For FDI to have an appreciable impact on economic growth, countries must have minimum capacity to absorb the growth-enhancing benefits of FDI. Thus, achieving the FDI threshold level is a necessary, but not sufficient, condition for economic growth. Some countries use tax incentives to improve FDI inflows. The study stressed that such incentives may be counterproductive at low levels of FDI inflows: FDI coefficient estimates below the lowest threshold level are negative, implying that the higher costs of such incentives exceed the potential benefits availed by FDI's direct contribution to economic output and spillovers.

In the same vein, Emel and İlyas (2022) examined the effects of foreign direct investment (FDI) on Turkey's macroeconomic dynamics using a Structural Vector Autoregressive (SVAR) model. Their analysis spanned from 2005 to 2020 and utilized variables such as GDP growth, domestic investment, inflation, and import levels. The study found that FDI positively influenced economic growth and domestic investment, highlighting that foreign and domestic investments tend to be complementary. However, they also observed that FDI inflows put upward pressure on prices, balanced by monetary policy interventions. Additionally, while FDI had a significant effect on increasing imports, it did not substantially impact unemployment in Turkey.

Bergougui and Murshed (2023) examined the effect of foreign direct investment (FDI) inflows on overall growth, as well as its sector-specific spillovers in the Middle Eastern and North African region for the period 2000 to 2020. The study adopted dynamic panel GMM methodology. The study reveals that FDI significantly stimulates growth. But when disaggregated FDI data, primary sector FDI adversely affects the gross domestic product (GDP) growth in the service

sector and overall GDP growth. More so, secondary FDI has a 'double-edged' effect, benefiting its own sector (the service sector's GDP growth), but not other sectors. In contrast, service sector FDI stimulates GDP growth in mining, manufacturing and service sectors, thereby enhancing overall economic growth. The policy implications regarding the incentives provided by governments to encourage FDI, which need to be fine-tuned to attract certain types of FDI (tertiary), with less focus on the primary sector

Obetta, et al. (2023) re-examined the impact of foreign direct investment (FDI) on employment in Nigeria for the period of 1981 to 2021. The study adopted unit roots and co-integration and error correction models. The study reveals that a short-run relationship existed among the variables. The existence of a short-run relationship between FDI and employment in Nigeria is economically meaningful because it suggests that FDI could generate employment in the short run. Given the findings of the study, the study recommended that government should make an intensive effort to attract foreign direct investors into the country to encourage production and employment opportunities by creating attractive enabling environments of rule of law, good infrastructure, an acceptable level of security, human capital availability and also conscious efforts made to discourage the importation of foreign goods into the country.

Epor, Yua and Terhemba (2024) integrate the role of international trade and external debt in the FDI-economic growth nexus for Brazil, Nigeria, and Vietnam over the period 1990 to 2021. The study employs an autoregressive distributed lag (ARDL) model. The results of the study reveal that FDI and trade have positive but insignificant effects on economic growth in all three countries and that External debt hampers long-term economic growth in these countries. The study proposes country-specific recommendations that take into account specific economic and financial conditions, global market dynamics, and the long-term development goals of developing countries.

Francis et. al., (2024) examined the impact of foreign direct investment on economic growth in Nigeria for the period 1981 to 2022. In the study, economic growth was proxied using real gross domestic product growth while the explanatory variables were foreign direct investment, gross fixed capital formation, per capita income and exchange rate. The eclectic paradigm and endogenous growth theory served as the theoretical framework for the study and the data were analysed using the ARDL model. The results of the study revealed that in the long run, foreign direct investment, per capita income and exchange

rate had an insignificant effect on economic growth in Nigeria although gross fixed capital formation was insignificant. In the short-run, gross fixed capital formation had a significant negative impact on economic growth. This showed that a unit increase in gross fixed capital formation decreased growth within the study period. Based on the findings, the study recommends that investment in human capital development focusing on technical skills relevant in manufacturing and service sectors to attract FDI as well as economic growth in Nigeria.

Al-Muizzuddin (2024) analysed the impact of foreign direct investment (FDI) on economic growth at the provincial level (33 provinces) in Indonesia. The study adopted sectoral data from 2010–2019 which was analysed using a fixed effects estimator. The result of the study revealed that foreign direct investment in the mining, manufacturing, water, gas and electricity, hotels and restaurants, and real estate sectors had a significant positive effect on economic growth. In Indonesia FDI in the agricultural sector had a significant negative impact on growth while FDI in the manufacturing sector contributed positively to economic growth in Indonesia. A similar study by Doan (2024), for Association of Southeast Asian Nations (ASEAN-6 countries) such as Indonesia, Malaysia, Thailand, Phillipines and Vietnam found that FDI and control of corruption had an important role in promoting economic growth.

3. Methodology

Theoretical Framework

This study draws on the endogenous growth theories which highlight the relationship between FDI and economic progress. They focus on human capital, knowledge, and research and development spillover effects. Proponents like Romer (1990), Lucas (1988), Mankiw, Romer, and Weli (1992), etc emphasized that technological progress, including new idea generation, is crucial for long-term economic growth. Endogenous growth models introduce various types of capital accumulation, such as human capital and knowledge, not subject to diminishing marginal returns. These models underscore the importance of economies of scale and human capital on labour productivity increase. They also address market imperfections and the role of technical change, suggesting that technical progress results from capital deepening and the introduction of new capital goods and services, often brought in by multinational enterprises (MNEs), fostering external returns to capital, especially human capital.

Model Specification

To examine the impact of foreign direct investment inflows on economic growth, we lean on the modified version of Romer's

(1986) augmented Cobb-Douglass production function for endogenous growth in panel framework but follow the empirical application of Francis et al., (2024) where real GDP is modelled as a function of foreign direct investment inflow. However, the specified model departs from extent specification because the potential feedback effect between RGDP and foreign direct investment inflows is considered. The model is thus specified as follows:

$$RGDP = f(FDI, GFCF, POP, EXR) \quad (3.1)$$

Re-writing our model in panel dynamic form we will have: -

$$RGDP = \beta o + \beta_1 FDI_{it-1} + \beta_2 GFCF_{it} + \beta_3 POP_{it} + \beta_4 EXR_{it} + \varepsilon_{it} \quad (3.2)$$

Where, RGDP is gross domestic product, FDI is Foreign Direct Investment, GFCF is gross fixed capital formation, POP is Percentage of total Population (Age 15 – 65 years), EXR is exchange rate, βo is the intercept of the equation, ε is the stochastic term or error term assumed to be normally and independently distributed with zero mean and constant variance. It captures all other explanatory variables which influence economic growth but are not captured in the model, while i is cross sectional identities, and t is time.

The data used for the study cover the period 2000 – 2022. The sample comprises 25 sub-Saharan African countries that were selected based on data availability. The countries are Angola (ANG), Benin (BEN), Botswana (BOTSW), Burkina Faso (BKF), Cameron (CAMR), Central African Republic (CAF), Congo Republic (CONGO R), Cote d'Ivoire, Eswatini, Gabon, Ghana (GH), Kenya (KEN), Mali, Mauritania, Mauritius, Mozambique, Namibia, Niger, Nigeria (NGA), Rwanda, Senegal (SEN), Sierra Leone, South Africa, Togo and Uganda. All the data were sourced from World Bank's World Development Indicators. In terms of data used, the variables are real gross domestic product (measured by GDP growth rate), foreign direct investment inflows (percentage of GDP), gross fixed capital formation (percentage of GDP), population growth (percentage of total population aged 16 – 65 years) and real exchange rate.

4. Results and Discussing of Findings

The summary of the descriptive statistics of the variables used in estimating the research model in the study is presented in Table 4.1.

Table 4.1: Summary of Descriptive Statistics

Variables	RGDP	FDI	GFCF	POP	EXR
Mean	2485.199	5.045131	8.517759	55.21273	397.6997
Max.	10892.54	84.93685	155.2265	71.21441	3727.069
Min.	267.5285	-11.19897	-3.790521	47.28657	-189.6287
Std. Dev.	2624.432	8.995328	18.31219	4.921037	541.6076
Skewness	1.435388	4.655735	4.043789	1.334867	3.526538
Kurtosis	3.899187	30.14249	22.58061	4.820037	19.58114
J-B	216.8203	19727.73	10752.72	250.1254	7778.797
Prob.	0.000000	0.000000	0.000000	0.000000	0.000000

Source: Researchers' Computation

Table 4.1 shows that economic growth proxy by real GDP, has the highest mean followed by Exchange rate (EXR), Population growth (POP), Gross Fixed Capital Formation (GFCF) and Foreign Direct Investment respectively. Skewness is the measure of asymmetry of the data around its mean; the five variables are negatively skewed i.e. the data has a long left tail. Standard deviation shows the rate of volatility of the dataset.

The Kurtosis shows that all the variables are less than 3 i.e. platykurtic distribution meaning the distribution is flat relative to normal. The Jarque-Bera shows normality distribution of data. The high Jarque-Bera probability above 0.05% as shown in the table means acceptance of the null hypothesis that the variables are normally distributed.

The correlation matrix was tested and the result presented in Table 4.2.

Table 4.2: Correlation Matrix

Correlation					
Model 3	**RGDP**	**FDI**	**GFCF**	**POP**	**EXR**
RGDP	1				

FDI	-0.08241	1			
	0.0482	-----			
GFCF	0.192048	-0.12691	1		
	0	0.0023	-----		
POP	0.77308	-0.06321	0.170008	1	
	0	0.1301	0	-----	
EXR	-0.26392	-0.07825	-0.10938	-0.38956	1
	0	0.0608	0.0087	0	-----

Source: Researchers' computation using Eview 9.0

As presented in Table 4.2, regressors do not have perfect or exact linear representations of one another. From the result, it can be seen that there is no linear dependency between dependent and independent variables. This is because none of the explanatory variables has correlation coefficient up to 0.8. It is therefore, safe to conclude that there is no problem of multicollinearity that could undermine the efficacy of this model.

As seen in Table 4.3, all the Lagrange multiplier (LM) tests including Pesaran cross-section dependence (CD) reveal the existence of cross-sectional dependence at a 1% significance level for all the variables. Hence, we conduct a unit root test which allows for cross-sectional dependence. Table 4 is the Pesaran panel unit root test in the presence of cross-sectional dependence i.e. cross-section in Pesaran and cross-section augmented Dickey-Fuller (CIPS and CADF).

Table 4.3 Cross-Section Dependence Test Result

Cross-Sectional Dependence Test				
Var	**Breusch-Pagan LM**	**Pesaran scaled LM**	**Bias-corrected scaled LM**	**Pesaran CD**
RGDP	**1079.686*** (0.000)**	**79.17282*** (0.000)**	**78.87737*** (0.0000)**	**31.70365*** (0.000)**
FDI	**302.5649*** (0.000)**	**16.93875*** (0.000)**	**16.64329*** (0.0000)**	**3.896714*** (0.000)**
GFCF	**3238.243*** (0.000)**	**118.9286*** (0.000)**	**118.3604*** (0.0000)**	**52.24226*** (0.000)**
POP	**33939.526*** (0.000)**	**147.5624*** (0.000)**	**146.9942*** (0.0000)**	**34.70891*** (0.000)**
EXR	**1301.214*** (0.000)**	**96.8947*** (0.000)**	**96.59925*** (0.000)**	**35.3894*** (0.000)**

Values in brackets indicate probability values; *, **, and *** indicate significance at 10% level, 5% level, and 1% level, respectively. Null hypothesis: no cross-sectional dependence; Ha: there is cross-sectional dependence among groups or firms

Source: Researchers' Computation using Eview 9.0

Table 4.4: Summary of Unit Root Test Results

	CIPS			CADF		
	Level	**1st Diff.**	**Decision**	**Level**	**1st Diff.**	**Decision**
RGDP	-2.081	-4.646	I(1)	-1.323	-2.552	I(1)
FDI	-2.361	-4.749	I(1)	0.175	-7.324	I(1)
GFCF	-1.789	-4.278	I(1)	-1.308	-3.371	I(1)
POP	-3.205	-2.252	I(1)	-3.195	-2.548	I(1)
EXR	-2.643	-3.846	I(0)	-2.576	-2.576	I(0)

Source: Researchers' Computation using Eview 9.0

From Table 4.4, Pesaran panel unit root test was estimated. Our panel unit root test results using CIPS and CADF reveals that all the CIPS and CADF statistics are greater than their critical values of 10%, 5%, and 1% at their first difference. This implies that the variables are integrated of order one [I(1)] except EXR which was integrated of order zero [I(0)]. This test is motivated by the outcome of the cross-sectional dependence test. Therefore, we estimate the panel co-integration.

Table 4.5: Panel cointegration Test Result

Results for H0: no cointegration
With 25 series and 4 covariates

Statistic	Value	Z-value	P-value
Gt	-2.132	- 0.744	0.229
Ga	-0.313	6.726	1.000
Pt	-3.231	3.830	1.000
Pa	-0.296	3.979	1.000

All test statistics are distributed N(0,1), under a null of no cointegration, and diverge to negative infinity (save for panel v).

Source: Researchers' Computation using Eview 9.0

From Table 4.5, it can be seen that the co-integration results indicate that there are four outcomes such as Gt-statistics, Ga-statistics, Pt-statistics and Pa-statistics. These have their corresponding probability values. The null hypothesis states that there is no co-integration among the variables. However, the p-values of the entire outcome are non-significant. In other words there is no long-run relationship among the variables. Hence, we estimate PMG.

Table 4.6: Results of Panel non-linear Test

Variables	**(RGDP)**		
Longrun	**Coeff.**	**t-Stat.**	**Prob**
FDI	0.08723	25.93606	0.0000
GFCF	0.039025	14.14136	0.0000
POP	0.939762	61.04201	0.0000
EXR	0.095725	10.42106	0.0000
Short run			
FDI	-0.02266	-2.13348	0.0343
GFCF	-0.10366	-0.65301	0.5146
POP	-1.75585	-0.28915	0.7728
EXR	-0.84061	-0.9838	0.3266
ECT(-1)	-0.21809	-2.20853	0.0285

Source: Researchers' Computation using Eview 9.0

Table 4.6, shows that foreign direct investment, gross fixed capital formation, population growth and exchange rate have positive and significant effects on RGDP. This suggests the following: one unit increase in FDI leads to 0.08723 increase in RGDP, one unit increase in GFCF leads to 0.039025 increase in RGDP, one unit increase in POP leads to 0.939762 increase in RGDP, and one unit increase in EXR leads to 0.095725 increase in RGDP. In the short-run, all the explanatory variables exert negative and non-significant effect on RGDP except FDI which is significant. The ECT (-1) on the other hand is negative and significant, which implies that it is rightly signed. Thus, disequilibrium from

the short-run to the long-run is corrected at 21% speed of adjustment.

Considering the long run coefficients, a unit change in FDI inflows leads to a rise in growth rate in the sub-Saharan African countries economy. This implies that FDI has the capacity to stimulate growth in SSA. This finding is in line with some studies in extant literature such as Emel and Ilyas (2022); Bergougui and Murshed (2023); Al Muizzuddin (2024); Doan (2024) but is contrary with the studies by some scholars such as Epor, Yua and Terhemba (2024); Francis, Ebimowei and Peres (2024). The coefficient of gross fixed capital formation, population growth, and exchange rate showed positive relationship. This result conforms to a priori since economic growth should naturally increase as the economy progresses.

5. Conclusion and Policy Recommendations

Sequel to the findings discussed above, FDI is seen as a factor that fosters economic expansion and development in SSA for the period of study under investigation. Governments in this region should take action towards attracting FDI that aligns with sustainable development objectives, such as investments in renewable energy, sustainable infrastructure, and environmentally friendly technologies, Channel foreign and domestic investment into sectors that contribute to long-term economic growth, such as education, innovation and infrastructure development. Enhance the skills and capabilities of the workforce through education and training programs, which can increase productivity and drive economic growth. Maintain a stable exchange rate regime to provide certainty for investors and businesses, which can foster investment and economic growth and integrate environmental considerations into economic policies and investment decisions to ensure that growth is environmentally sustainable in the long term. By implementing these strategies, sub-Saharan African countries can achieve sustainable economic growth that balances economic prosperity with environmental and social considerations.

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