

DETERMINANTS OF FOREIGN DIRECT INVESTMENT IN AFRICA

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This paper uses a cross-country econometric approach to identify the determinants for FDI in Africa. The contribution is threefold. Firstly, we recognize that the estimation techniques used elsewhere, such as OLS, may be flawed. We therefore use a dynamic one-step Generalized Method of Moments (GMM) estimator due to Arellano & Bond (1991). We also argue that significant outliers mark FDI inflows to Africa and therefore use a semi-parametric estimator, the Least Absolute Deviation (LAD) estimator. Secondly, this paper critically reviews the claims for the dominance of economic policies – such as policies to foster openness, in attraction of FDI. Thirdly we focus on quantifying the significance of institutions and geography for FDI flows to Africa. From the various results we conclude that geography does not seem to have a direct influence on FDI flows to Africa, but indirect through its influence of institutions. Also we find that neither market-seeking nor re-exporting motives of FDI seem to dominate, with different policy instruments being significant in the different specifications. This does not discount the importance of good policies, but rather indicates the importance of good policies made by good institutions. Throughout, institutions, in the form of political stability showed up as a significant determinant of FDI.