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The Slow growth of Foreign Direct Investment in Central African Republic

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Abstract

Large amounts of foreign direct investment have been attracted by many African countries. Yet the Central African Republic is by far less attractive in the perspective of potential investors. The aim of this paper is to investigate the slow inflows and growth of FDI in the country. In the short-run and long-run we found out that the Gross Domestic Product growth, the domestic credit to private sector, the electricity production and the quality of public administration are not significant. The Error Correction Mechanism is significant at 0.05 which demonstrates that the speed of adjustment of the model from short-run to long-run is about 46%. It is very important for Central African Republic to renovate the national electricity supply company by increasing the hydro- electric production.

JEL Classification: C52; F21; F23; P37; P39

Keywords: Slow Growth of FDI, ECM, Long -run, Short-run, Central African Republic

I. Introduction

Foreign direct investment which is one of the major key elements in economic globalization has received an increasing interest in recent years. According to the United Nations Conference on Trade and Development (UNCTAD) the annual average FDI that inflows to Africa doubled during the 1980s to \$2.2 billion compared to the 1970s, and increased significantly to \$6.2 billion and \$13.8 billion respectively during the 1990s and 2000-2003 and 57 billion in 2015. FDI inflows to Central African Republic decreased slightly in 2006, to 24million USD, from 29 million in 2005. According to the country report conducted by the economist Intelligence Unit (2008), Central African Republic has a history of low FDI inflows challenged by political instability, small domestic market, and high transport

costs. Compared with its neighbours the amount of foreign direct investment that flows in the country is miniscule, representing just 3.4% of Chad's (700 million USD) in 2006.

Despite the openness to foreign investment based central African charter created in 2001 to encourage private sector development by attracting domestic foreign investors, Central African Republic still fails to attract tangible foreign investors capable of triggering economic expansion. The country is ranked 7th for FDI in Central Africa Region (receiving \$12.1 billion of FDI in 2014, i.e. about 33 per cent from 2013) and 39th out of 46 for sub-Saharan Africa. According to trading economic website, FDI inflows in Central African Republic was at 5% of GDP in 2013, which is quite low compared to the amount received by other African countries like Namibia, Algeria and Nigeria. These countries had their FDI net inflows increased by more than 500 million (FMI 2013b). The highest values in Central Africa Republic's history since 36 years ago was 5.90 (...) in 2008 compared to -0.78 (...) in 1993 (Index mundi website). In the context of continent scale and FDI in Africa, the Central African Republic receives only 0.03% of global FDI flows (15 billion USD in 2003) and 0.07% (167 Billion USD) of FDI stocks.

The question therefore arises as what actually slows down inflows of foreign direct investment. The aim of this paper is to investigate the slow inflows and growth of FDI in the country. This article is organized as follows: following the introduction in section I, the section II reviewing relevant literatures used. Objectives of the study in section III, rationale behind of the study in section IV. Methodology, data source and sample frame in section V. Empirical model occupies the section VI. Analysis of the data in section VII, conclusion in section VIII, while section IX provides the limitations of the study.

II. Review of literature.

There are numerous empirical literatures that attempt to provide understanding about the factors that affect foreign direct investment in Africa.

Consider using one of the following reference cases Dunning (1998) explained about the electric theory of FDI which has been become very key and strong instrument for analyzing the relationship between FDI and economic Growth. Alfaro (2003) found out that the host countries of FDI have developed financial markets significantly. He also argued that better financial markets help local agents in the host economy take advantage of knowledge spillovers from FDI. In Ethiopia found that liberalization, the growth rate of real GDP, and the export have positive impact on FDI while poor infrastructure and macroeconomic instability cause a negative relationship.

Yasin (2005) argued that bilateral and multilateral aids can reduce obstacles to FDI flows, and thus improve the economic condition to attract FDI. Fedderke and Romm (2000) found a negative figure of labor capital which implies that South Africa has a tendency to be capital intensive. The proponent's hypothesis has long been argued that the openness is very important to attract FDI.

Neumayer (2005), YanLing (2012) advocated that liberal trade policies encourage FDI. Naihua et.al (2013) by investigating on trends, Patterns and determinants of foreign direct investment in China covering the period of 1985-2006 by employing panel data analysis, found that domestic market, openness, infrastructure as well as lower wage rate have been key factors in attracting FDI in China.

The level of human capital can be identified as one of the determinants for attracting investors to host countries (Noorbakhsh, Paloni, et.al. 2001). These variables employed, such as: education index, secondary school enrolment, the government expenditure in education confirmed the human capital over time as significant in FDI attractiveness. As we know today, the quality of human resources has become more and more dominant factors in sustaining FDI flows. The higher the level of education of the country, higher will be the chance to attract FDI. Infrastructure quality in attracting FDI has lately received increasing interest from many researchers. Boopen (2009), Khadaroo and Boopen (2008) found that the robust coefficient of transport is positive and significant while Ntim and Yaroson (2014) results show that the level of FDI inflows is significantly related to the quality of institution. These studies carry out to analyze how much foreign direct investment is sensitive with the quality of infrastructure. Good infrastructure increases the productivity and stimulates FDI flows.

An efficient financial system is also necessary in attracting capital investment. Over 70% of the total world inflows have been located in the OECD Countries just because throughout many years ago those countries have developed the standards for international investors which really help them to protect and simplify investment process. This variable also captured the interest of researchers in recent years.

Yapatake Kosselle et.al (2015) by employing domestic credit to private sector to capture the efficiency and reliability of the financial development found that domestic credit to private sector has greater influence on FDI. Sghaier and Abida (2013) found that the development of the domestic financial system is an important factor for FDI to have a greater influence on economic growth.

Manpreet et.al (2013) by examining the relationship between financial development and foreign direct investment in BRIC countries by using panel data covering the period of 1991-2010 found FDI is positively affected by size of Banking sector and stock market capitalization. They also found that more domestic credit by banking sector affects negatively FDI inflows in these countries.

Almfraji and Almsafir (2013) argued that foreign direct investment can have positive, negative relationship and in some cases null. Sun et al (2002) by conducting the study on the determinant of Foreign direct investment in among China's 30 provinces from 1986-1998 argued that the cumulative FDI relative to cumulative domestic investment has a negative effect on FDI.

The role of growth in attracting FDI remained the subject of debate. Lunn (1980), Culem (1988), found a positive and significant impact of Growth on FDI as Schneider and Frey (1985). Nezakati et.al (2011) by manipulating Vector Auto Regression, Granger causality and co-integration test methods

between foreign direct investment and domestic credit to private sector showed that there exists a causal relationship between FDI and domestic credit and also cointegrated. Sourafel Garma (2008) put forward that better access to credit is an important channel through which FDI affects the innovation of domestic private.

Political stability was identified in many previous studies as the factor that deters the Foreign Direct Investment in the host country. Lemi and Asefa (2003) found that the impact of political uncertainty affected FDI in Africa. Wisniewski and Pathan (2014) found that more FDI will to countries when such countries are influenced by good presidential systems, established political parties and good judiciary and parliament are strongly exercised.

No empirical study was made to explain the reason of the slow growth inflows of FDI in this country. The most of available research are on FDI in Africa are too general not specific in terms of slow growth as this case. Besides the area of the factors that affect the FDI inflows in Central African Republic there are some other theoretical reasons that this study will attempt to provide. For instance post-colonial impact and treaties signed before the country gained independence which affect negatively the political stability of the country as well FDI inflows.

Iamsiraroj (2015) by examining the nexus between foreign direct investment and economic growth by using cross-country analysis covering the period 1971-2010 in 124 countries found that FDI have a positive relationship with economic growth. Elliott et.al (2013) by investigating the relationship between the energy intensity of Chinese cities and the location of firms found a negative relationship between foreign direct investment flows into a city and energy intensity.

Kuzmina et.al (2014) by conducting the study on foreign direct investment and governance quality in Russia found that higher pressure from regulatory agencies , frequency of illegal payment , criminals and enforcement authorities affected negatively the FDI . They also find that during 1895-1914, the period before the October revolution by moving from the average to the top governance quality doubles the FDI stock.

III. Objective of the study

The objective of this study is to examine what actually slows down inflows of foreign direct investment in Central African Republic. In addition to that the intention of this paper is to investigate if the variables included in our model such as: domestic credit to private sector, electricity production, quality of public administration deter FDI in the country

IV. Rationale of the studies

The rationale behind of this research is contributed to the fact that no study have been done to explain the reasons of slow growth inflows of FDI in this country. This study is the first quantitative analysis attempt to clarify the reasons behind the slow of FDI in Central African Republic.

V. Methodology, data source and sample frame

The article covers the period of 1996 to 2014. The paper used secondary time series data. Information on GDP growth, the quality of public administration and the domestic credit to private sector were collected from World Bank especially from World development Indicators database. Electricity production data was collected from different sources such as: indexmundi, mecometer, actualitix website and Central intelligence agency (CIA) available at: www.indexmundi.com/fr/, www.mecometer.com, www.actualitix.com, www.cia.gov/fr/ respectively.

This paper used error correction model (ECM). In order to understand the reasons behind the slow growth of Foreign Direct Investment in Central African Republic I will begin our analysis by times series preliminary tests such as: Augmented Dickey-Fuller and Philips Perron Unit Root Test, because one the main problem often related with empirical analysis is non-stationary of our variables. When variables being used in our analysis are non-stationary will lead us to spurious regression results and non –accurate t-statistic, DW statistic as well as the R^2 . Granger causality is also employed. The existence of a relationship among the variables does not prove causality or direct influence. The Granger causality regression analysis deals with the dependence of one variable on the other variables.

Our analysis made use error correction model (ECM) both the short and long run. However, the Johansen co integration test of long –term economic relationship was performed in purpose to check the steady equilibrium of the variables employed in our study. The results of both trace and Maximum –Eigen value of Johansen co integration will be presented. Finally to ascertain the evaluation of our model, the stability test are conducted both cumulative sum (CUSUM) and the cumulative sum of squares (CUSUMSQ)

VI. Empirical model

Based on above statement, I hypothesize the following mathematical specification of the model where ε_t represented variables outside the model.

$$NI_t = f(GR_t, DC_t, E_t, QPA_t) \varepsilon_t \dots\dots\dots (1)$$

The following model is employed for the purpose of understanding the reasons for the slow growth of FDI in Central African Republic.

$$NI_t = \alpha_0 + \alpha_1 GR_t + \alpha_2 DC_t + \alpha_3 E_t + \alpha_4 QPA_t + \varepsilon_t \dots\dots\dots (2)$$

Where:

GR= Gross domestic product (%)

DC= domestic credit to private sector (%)

E= electricity production (Kwh)

QPA= quality of public administration (with 1=low to 6= high)

α =Error term

α = coefficient

For this study, was used the GDP growth, the domestic credit to private sector, the quality of public administration and electricity production to investigate on the reasons for slow growth of Foreign Direct Investment in Central African Republic.

Central African Republic's economy has hardly experienced flourishing economic returns since independence. According to African Economic Outlook (2015), Central African Republic shows a slightly improvement in 2014 with a growth rate of the real GDP of 1.0%, compare to an initial target of 1.5% and a decrease of 36.0% in 2013. The trading economic website also shows that the GDP Annual Growth Rate was averaged at 1.50 percent from 1961 to 2013, which reaching an all-time high of 9.48 percent in 1984 and a revealing a lower of -9.20 percent in 2013. After reaching a peak in 2006, growth weakened substantially in 2008 and 2009 as a result of a series of internal and external shocks that hit the economy including the oil and food price shock and the global financial crisis. Growth rebounded in 2010 but remains vulnerable to increases in the world prices of fuel and food. I expected the slow GDP growth to be insignificant and one of the factor that deters FDI in the country.

The banking sector was, and remains generally stable and fragile. Despite the fact that the penetration of the Banking system is low in Central African Republic, there still remains high interest rate averaging about 15 percent. In addition to that, Central African Republic also was hindered by the access to financial service. This resulted to 1 percent of the total population holding bank accounts, 0.5 percent

with outstanding loans and 1 percent accessing microfinance institutions according to International Monetary Fund (2009). The private sectors were also in dilemma in obtaining credit from banks. The difficulty in obtaining bank credits mostly contributed to hard terms and high financing costs from banks causing the stagnation of development for private sector. The Civil war in 2013, made a huge threat to the economic growth of the country, development of private sectors as well as banks and other micro-finance institutions as a whole. I expected domestic credit to private sector to be insignificant and slows down the FDI inflows in Central African Republic. The study uses domestic credit to private sector as a proxy. This variable is used based on the notion that domestic credits to private sector lead to sustainable development of local companies which will affect the economic growth of a country.

Number of phenomena that constitute major challenges for its government. These phenomena greatly affect the functioning of all public services and state institutions. First it is related to the competitiveness of services, resources and knowledge. Second is the development based on knowledge or expertise. The complexity of the development process related challenges and strategic decisions require not only extensive experience but also an assertive mastery of the knowledge areas involved. The third remarkable phenomenon in Central African Republic is that of brain drain. A Lot of Central African citizens after finishing their studies abroad do not return to their home country. This phenomenon particularly influences good qualified labour force thus reducing competitiveness in the public administration as well as well in the private sectors. The fourth phenomenon is the inadequate use of information technology and communication (ICT). ICT is a new technology that facilitates communication remotely, through the transmission of data and information. The use of ICT in Central Africa Republic is inadequate as the system has been damaged and dilapidated on a larger extent as a result of decade of civil unrest. ICT use is inadequate to ensure country coverage and do not meet the needs of increasingly growing populations and emerging needs. We expected public administration to be insignificant and as one of the factors that slowdown the FDI inflows in the country. Quality of public management, organization, functioning, and administration effectiveness can be looked at as the determinant FDI. A better quality public administration improves the FDI inflows, increasing the transparency as well investors' confidence.

The electricity sector in the Central African Republic is underdeveloped due to the large size of the country and its low population density. This creates social and political instability on the network infrastructure, as well as the weak performance of ENERCA or Energie Centrafricaine (the company in charge of production and supply of electricity in Central African Republic). As we know this sector is one of the strategic areas in all modern economies because the ability to supply electric energy reliably and at reasonable cost is crucial to any productive activity especially in attracting FDI. Due to the

problems of electricity in the Country, I expected this variable to be insignificant and an obstacle to the inflows of Foreign Direct Investment in Central African Republic and not significant.

VII. Analysis

Table 1: ADF Unit Root Test.

This table presents the results of the preliminary times series test of unit Roots to avoid spurious regression. The null hypothesis of the unit root test of all the variables cannot be rejected at level. I see that at level GDP is stationary at of 5%, but the rest of the variables including the dependent variable are not stationary. However at first difference all our variables become stationary at either 1%, 5% or 10%.

Variables	Level		First Difference		
	T. Statistic	Prob	T. Statistic	Prob	Included
QPA	-2.7827	0.2201	-4.3010	0.0189***	Trend and Intercept
GR	-4.9911	0.0046***	-7.7529	0.0001***	Trend and Intercept
LE	0.2031	0.4647	-2.7127	0.0964*	Trend and Intercept
DC	2.2595	0.0368	-2.5461	0.0144***	None
NI	-1.4718	0.5230	-3.1419	0.0423**	Intercept

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

Source: Prepared by the author, based on Eview 8

Table 2: Philips Perron Unit Root Test

The table 2 shows that the PP unit root test for GDP is significant at 1% level. But at the first difference all independents variables and the dependent variable become stationary. This is an indication that the variables are all integrated of order one I [1] hence co integrated. However, Table 1 and Table 2 indicate that at the first difference all the variables are stationary and we reject the null hypothesis of the existence of unit root.

Variables	Level		First Difference		Included
	T. Statistic	Prob	T. Statistic	Prob	
					Trend and Intercept
LQPA	-2.7062	0.24521	-11.3755	0.0000***	
					Trend and Intercept
LGDP	5.0068	0.0045***	-9.2583	0.0000***	
					Trend and Intercept
LE	1.8604	0.6237	-3.8119	0.0419*	
LDC	2.3944	0.9934	-2.5477	0.0143***	None
LNI	-1.2676	0.6206	3.11377	0.0445**	Intercept

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

Source: Prepared by the author, based on Eview 8

Table 3: Johansen Trace Test for Co-integration

Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob**
None *	0.937363	93.12807	69.81889	0.0000
At most 1 *	0.759878	46.03125	47.85613	0.0536
At most 2	0.535280	21.77892	29.79707	0.6815
At most 3	0.321472	8.751466	15.49471	0.4766
At most 4 *	0.119233	2.158360	3.841466	0.0479

Trace test indicates 2 cointegrating egn(s) at the 5% level

Source: Prepared by the author, based on Eview 8

Table 4: Johansen Maximum Eigen values for Co-integration

Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob**
None *	0.937363	47.09681	33.87687	0.0008
At most 1 *	0.759878	24.25233	27.58434	0.1262
At most 2	0.535280	13.02746	21.13162	0.4497
At most 3	0.321472	6.593105	14.26460	0.5383
	0.119233	2.158360	3.841466	0.1418
At most 4 *				

Maximum Eigen-Value test indicates 1 Co integrating Equation(s) at the 0.05 level

Source: Prepared by the author, based on Eview 8

It can be seen from in the table 3 that the trace statistic indicates the presence of two cointegration among the independent variables. Table 4 shows that Max-Eigen Value indicates one co-integrating variable at 1% level. This confirms the existence of a stable long-run relationship among the foreign direct investment (NI) as the dependent variable, growth (GR), Quality of public administration (QPA), electricity production (E), and domestic credit to private sector (DC) as the independent variables. Also a steady relationship exists between NI as dependent variable. Based on the Table 3 and 4 we reject the null hypothesis of no co-integrating equations.

Table 5: Granger Causality Test Results

Null Hypothesis	F. Statistic	Prob.
GR does not Granger Cause LNI	0.00331	0.9549
NI does not Granger Cause LGDP	0.06533	0.8017
LE does not Granger Cause LNI	3.09312	0.0990***
LNI does not Granger Cause LE	0.00293	0.9575
DC does not Granger Cause LNI	1.45772	0.2460
NI does not Granger Cause LDC	0.13886	0.7146
QPA does not Granger Cause LNI	1.16036	0.2984
NI does not Granger Cause LQPA	0.04001	0.8441

, * denote rejection of the hypothesis at the 0.05 and 0.10 levels

Source: Prepared by the author, based on Eview 8

The results of granger causality test in table 5 shows that there is a unidirectional causality between electricity production (E) and foreign direct investment (NI) running from LE to GDP. Moreover, there is also no causality existing between GDP, DC, QPA which demonstrate this three independents variables doesn't affect the foreign direct investment in Central African Republic.

Short- Run Analysis and correction mechanism

The ECT is expected to have a negative sign and to be statistically significant. The negative sign implies that shocks occurring in the short run will be corrected in the long run. If the absolute value of the ECT is greater, then convergence towards equilibrium will be taking place faster.

Table 6: short run analysis, Error Correction Mechanism

Variable	Coefficient	Std. Error	T.Statistic	Prob
D (NI (-1))	0.328075	0.268191	1.223289	0.2523
D (GR (-1))	-0.001643	0.002470	-0.665115	0.5227
D(E (-1))	0.221064	0.738171	0.299476	0.7714
D (DC (-1))	0.000522	0.093135	0.005610	0.9956
D (QPA (-1))	0.007094	0.082873	0.085602	0.9337
ECM (-1)	-0.463931	0.213080	-2.177261	0.0574

*, ** indicate significance at 1%, 5% and 10% level

Source: Prepared by the author, based on Eview 8

Table 7: Long- Run Analysis

Variable	Coefficient	Std. Error	T.Statistic	Prob
GR	0.000751	0.004554	0.164851	0.8714
LE	-0.610389	0.740860	-0.823892	0.4238
LDC	0.049826	0.088700	0.561733	0.5832
LQPA	-0.043866	0.179835	-0.243922	0.8108
C	7.213216	0.591411	12.19662	0.0000

*, ** indicate significance at 1%, 5% and 10% level

Source: Prepared by the author, based on Eview 8

Table 6 presents the short run dynamic relationship and the set of short run coefficients in the vector error correction model. The error correction term is -0.4639 which determined that the speed of adjustment is about 46%. The coefficient is negative and significant demonstrated an existing co-integration

relationship among our variables. From table 6, the past year of GDP impacts negatively on current NI in the short run but positively in the long run. Electricity affects negatively the NI in the long- run (table 7) but in short term affect positively the NI of 0.22 (table 6). Domestic credit to private sector (DC) is not significant, where it exerts a positive impact on NI in short and long term respectively at 0.0000 and 0.04. Quality of public administration is not significant but impact positively the NI, while in long run affect its negatively at -0.007.

Test of ECM stability

The existence of cointegration coming does not unavoidably denote that the estimated coefficients are stable. It is in this purpose that Pesaran et al. (2001) proposed the test of stability of the estimated coefficients in the estimated models using the tests of Brown et al. (1975), which are known as the cumulative sum (CUSUM) and the cumulative sum of squares (CUSUMSQ). The ECM of equation in figure 1 and figure 2 is preferred in order to apply the stability test of Brown et al. (1975). The stability of the model of FDI in Central African Republic indicates that the model has been stable since no root lie outside the range of the conditions. The recursive residual test satisfies the stability test at 5% significance level.

Source: Generated from on Eview 8.

VIII. Conclusion

Foreign Direct Investment plays a vital role in the economic development of African countries in terms of social and economic growth perspective. But Central African Republic still failed to attract foreign capital to support its economic growth. It is important for Central African Republic Authorities to support

financial sector development and improve access to credit, and have tabled plans to improve the legal and judiciary system to serve commercial matters. Due to globalization it is very important for Central African Republic to improve its quality of public administration in order to increase its competitiveness as well the promotion of domestic credit to private and the increase in output of electricity. Beside these problems there are many others factors that limit the country attractiveness: poor business climate, lack of infrastructure, the shortage of skilled labour force political instability and structural insecurity in many areas in the country. The collective consciousness and love of the nation will lead to sustainable development as well the increase in the FDI inflows.

IX. Limitations of the study

Besides the variables used in the model which tries to demonstrate the reasons for slow growth of Foreign Direct Investment in Central African Republic, there are lot of others variables or factors which can also affect the inflows of FDI in the country. Variables such as: customs trades and regulations, practices of informal sector, corruption, transportation, political instability, tax, crime theft and economic disorder were not used due to inadequacy of required data. The study was limited to those variable and factors for which adequate data could be sought.

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