THE EFFECTS OF FISCAL POLICY ON FOREIGN DIRECT INVESTMENT INFLOWS IN KENYA FOR THE PERIOD 2000-2014

BY

WANJALA, PHILIP SIMIYU

UNITED STATES INTERNATIONAL UNIVERSITY-AFRICA

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ID NO.625143

A Research Report Submitted to the Chandaria School of Business in Partial Fulfillment of the Requirement for the Degree on Master of Business Administration (MBA)

UNITED STATES INTERNATIONAL UNIVERSITY-AFRICA

SPRING 2016
STUDENT’S DECLARATION

I, the undersigned, declare that this is my original work and has not been submitted to any other college, institution or university other than the United States International University in Nairobi for academic credit.

Signed: __________________________  Date: __________________________
Wanjala, Philip Simiyu (ID No: 625143)

This project has been presented for examination with my approval as the appointed supervisor.

Signed: __________________________  Date: __________________________
Dr. Amos Njuguna

Signed: __________________________  Date: __________________________
Dean, Chandaria School of Business
FOREIGN DIRECT INVESTMENTS (FDI) plays a key role in attaining sustainable economic growth and development in most developing nations especially in Africa. This is majorly through; improving country’s attractiveness for FDI by strengthening infrastructural base, ICT development, raising productivity and generation of employment opportunities, and also supplementing the balance of payment by enriching exports. Since attracting foreign direct investment (FDI) is currently an important policy concern for the Kenyan Government, it is requisite to instigate benchmarks of the inward FDI flows.

The study, hence examined the effects of fiscal policy factors, specifically; balance-of-payments (current account deficit), government development expenditure on infrastructure and total external government debt on the amount of foreign direct investment inflows to Kenya. The study covered 15 years (from 2000 to 2014), a period adequate to provide definitive outcome. Bivariate Linear Regression was conducted in analyzing the secondary data that had been collected. A descriptive research design of quantitative nature was used to draw conclusions.

The study established that BOP’s current account deficit had a negative correlation with the FDI inflows to the country. This relation was revealed to be insignificant and this implied that adjustments in BOP’s current account deficit have a negligible effect on FDI inflows to Kenya. The results also indicate that government development expenditure on infrastructure had a significant positive effect on FDI inflows to Kenya. It is positively correlated to the FDI inflows, implicating that with a predetermined change in development expenditure on infrastructure, FDI inflows will oscillate in parallel direction. Consequently, a unit change in development expenditure on infrastructure in Kenya will translate to a positive net effect on the FDI inflows. The study further unveiled that total external government debt had an equally negative and insignificant relationship with the foreign direct investment inflows to Kenya. This implied that a unit change in total external government debt will have a net negative effect on the FDI inflows to the country.

Despite the fact that some fiscal factors under study have an insignificant connection with the level of foreign direct investment inflows that the country records, the effect remains
explicit. The findings of this paper have important policy implications for government to critically determine how to improve the country’s attractiveness for FDI. The government, other than developing expenditure reducing policies; tailor-made to regulate demand in the economy to reduce consumer spending in the economy particularly on imports, it is recommended that it incorporates expenditure switching policies to turn around consumers' expenditure away from imports and redirect towards goods of local origin. Also, with the evidenced revelation that government development expenditure on infrastructure positively impact foreign direct inflows although not directly, it is recommended that the national government allocates more funds to key infrastructural areas and projects that accelerate trade and investments into the country. Developed infrastructure increases a country’s attractiveness for FDI in the long run.

Kenyan should develop a sustainable framework to systematically integrate ethics and economic development based on structures and accountability through policies. Ethical matters should systematically be integrated into the primary constituents of the decision-making process for managing public resources within the bounds of this framework. Servicing of external debt causes servility on the economy as it invades the resources available for poverty eradication and propelling socio-economic development. In extreme cases of debt burden, debt restructuring should also be considered part of the adjustment package.
ACKNOWLEDGEMENT

Am grateful to God for the good health and wellbeing that were necessary to complete this project and MBA program.

I would also like to express my sincere gratitude to my supervisor Dr. Amos Njuguna for the continuous support throughout my research; his patience, motivation and immense knowledge. His guidance helped me in the research and writing of this thesis. I could not have imagined having a better supervisor for my MBA research.

Last but not the least, I would like to thank my family: my parents and to my brothers and only sister for supporting me spiritually throughout writing this thesis, MBA program and my life in general.
DEDICATION

This thesis is dedicated to my parents (Dr. & Mrs. Wanjala) for their love and endless support to ensure that I acquire this quality education.
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<tr>
<td>BOP</td>
<td>Balance of Payment</td>
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<tr>
<td>CAD</td>
<td>Current Account Deficit</td>
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<tr>
<td>CAGR</td>
<td>Compounded Annual Growth Rate</td>
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<tr>
<td>CBK</td>
<td>Central Bank of Kenya</td>
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<tr>
<td>DSA</td>
<td>Debt Sustainability Analysis</td>
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<tr>
<td>FDI</td>
<td>Foreign Direct Investments</td>
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<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<tr>
<td>HIPC</td>
<td>Heavily Indebted Poor Countries</td>
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<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>OECD</td>
<td>Organization for Economic Co-operation and Development</td>
</tr>
<tr>
<td>OMO</td>
<td>Open Market Operations</td>
</tr>
<tr>
<td>SAPs</td>
<td>Structural Adjustment Programs</td>
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<tr>
<td>SSA</td>
<td>Sub-Saharan Africa</td>
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<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
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</table>
CHAPTER ONE

1.0 INTRODUCTION

1.1 Background of the Problem

According to World Bank (1996), foreign direct investment (FDI), is a cross-border venture with an objective to secure a long lasting management interest for the long haul in a business enterprise in a country other than that of the investor’s. This interest is ordinarily 10% of voting stock. FDI in Kenya can be viewed as venture in assets usually foreign undertaken by a non-Kenyan citizen for production of goods and services to be sold locally or internationally. The foreign assets can be in form of rights, currency or property (Investment Promotion Centre Act, Chapter 518). The past century recorded a significantly increased flow of Foreign Direct Investment (FDI) to developing countries. The effect of these increased investments varies considerably between countries. Detailed analyses on the contribution of FDI to the economic growth of developing nations have been discussed (Borensztein, De Gregorio & Lee, 1998; Hermes & Lensink, 2003; Lall & Narula, 2004).

Most African nations aim to attract FDI having recognized it as a contributor to economic development (Nyamwange, 2007). Kenya, being eligible for Overseas Private Investment Corporation (OPIC) programmes and a member of the Multilateral Investment Guarantee Agency (MIGA), endeavors to undertake such investments to stimulate her development. Therefore, the economic determinants continue to play a significant role. However, the recognizable mix of geographical location benefits and created assets through developed infrastructure that Kenya can offer potential investors is likely to be more essential in future (Nyamwange, 2007).

The last three decades have recorded tremendous increase in foreign direct investment. For instance, global FDI has risen to US $ 1,833 billion in 2007 well above the US $ 1,748 billion in 2000 (UNCTAD, 2008). Multinational corporations and their foreign affiliates enjoyed a continued rise in production of goods and services as evidenced by increase in FDI from US $ 15 trillion in 2007 US $ 18 trillion in 2010 (UNCTAD, 2010). According to Abala (2006), the increase in FDI has been singled out as the most
important factor for poverty reduction. Furthermore, most developing countries such as Kenya are interested in FDI as a source of capital for industrialization. This is because FDI involves a long term commitment to the host country and contributes significantly to the gross fixed capital formation. FDI has been identified to contribute significantly to the economic growth of countries (Akinlo, 2004).

The perceived attractiveness for Africa’s relative to other regions has improved tremendously over the past years. Africa’s progress story in economic terms needs to be told more confidently and consistently having held the deep fascination for the developed world for long (Abala, 2014). Increasing self confidence continued strong growth in intra-African FDI (which has expanded by 42% since 2007) and significant shift in frame of mind and activities among African nations underscores this huge progress. The number of Foreign Direct Investment (FDI) projects in Africa grew 27% from 2010 to 2011, and have grown at a compound rate of close to 20% since 2007. In a survey conducted in 2013 by Ernst & Young, Africa now ranks as second-most attractive investment destination in the world up from third position in 2011. This implies that in terms of investment attractiveness, only North America ranks ahead of Africa. While this holds, in 2013, new FDI projects in Africa dropped for the second consecutive year, by a significant 3.1%. This saw job creation resulting from FDI projects also slowed in 2013. This was largely caused by the decline in North Africa, due to regional political uncertainty.

Nonetheless, in 2013, Sub-Sahara Africa (SSA) saw increase in the number of new FDI projects by 4.7%. Also, capital investment into Africa by a remarkable 12.9%, with a higher average project size from US$60.1m in 2012 to US$70.1m in 2013, (Ernst & Young, 2013). Furthermore, Africa’s share of global FDI flows has been improving year on year. In 2013, and marked as the highest level in a decade, Africa’s share of global FDI projects reached a whopping 5.7%. A detailed examination of United Nations Conference on Trade and Development (UNCTAD) FDI data also exhibits a trend of steady development; entities with presence in the region reinforcing their establishments by reinvesting their profits for growth.

Southern Africa is the forefront region in terms of presence of FDI projects within SSA, while remarkable development has been experienced in both East and West Africa. With
a widening lead, South Africa remains the dominant destination for FDI projects (De Mello, 1997). Nonetheless, a study by Ernst & Young in 2013 observed that countries including Kenya, Tanzania, Ghana, Nigeria, Mozambique and Uganda, are slowly showing noteworthy on a number of investors’ radars. Kenya and Ghana ranked in the top four in 2013 for the first time, having previously ranked in the bottom half of the top 10 FDI destinations.

On the other hand, significant growth in intra-regional investment share in Africa was noted (CAGR of 31.5% in FDI projects between 2007 and 2013). Improving regional value chains and strengthening regional integration has been observed as reason behind this noteworthy development as the share of FDI projects in Africa with other African countries as with sources reaching an all time high of 22.8% in 2013. Intra-African investment is second only to Western Europe as a source for FDI on the continent. Intra-African investments are also the second-largest source of job creation on the continent. South Africa, again leads as the most active intra-African investor. Kenya and Nigeria comes second and third respectively (De Mello, 1997).

Kenya has been the leading economy in the region since her in 1963. Over 4 decades later, Kenya retains that position, but in a very different world and after many ups and downs. In the late 1960s and early 1970s, Kenya opted for an import substitution strategy which resulted to creation of a more diversified economy. This was later followed by a long period of stagnation, in which governance deteriorated, infrastructure was neglected and foreign investment fell. Real income per capita actually declined between 1990 and 2002 (United Nations, 2005). However, ethnically-charged post-election violence in January-February 2008 caused many investors to reassess Kenya’s investment climate. Since then, the economy has rebounded, but GDP growth has not returned to 2007 levels. Serious concerns regarding corruption and governance have slowed Kenya’s economic growth, while some neighboring countries have maintained higher growth rates and more political stability (World Bank, 2014).

Foreign direct investment net inflows as a percentage of GDP in Kenya measured at 0.93 in 2013 (World Bank, 2013). FDI inflows for the East African territory stood at $6.2 billion; approximately Shs.545 billion in 2013 (UNCTAD, 2014) with Kenya’s inflows portion observed to be smaller than her East African counterparts. Kenya was delineated
as the least attractive FDI destination in the East African region (UNCTAD, 2008). The post election violence in 2008, after the 2007 General Elections triggered the plunge in FDI inflows to about US$96 million, approximately 0.3% of the country’s GDP in 2008. The country had savored a whooping US$729 million in FDI inflows; estimated to 2.7% of the county’s GDP the previous year.

Nonetheless, the country recorded an improvement in preceding years (2009 and 2010) with commendable performance of US$141 million and US$186 million in 2009 and 2010 respectively (World Bank, 2010). The country also observed a 98 percent improvement in 2013 with FDI inflows hitting $514 million mark (approximately Shs.45.18 billion), up from $259 million (approximately Shs.22.7 billion) in 2012. The major attributes to this massive improvement was oil and gas, and the manufacturing industries. Foreign Direct Investors also perceived the country as a regional hub for manufacturing, services and energy (World Economic Indicators, 2014). FDI inflow to Kenya is gradually resuming more strength.

### Table 1.1: Trends of foreign direct investment (FDI) in Kenya

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<tbody>
<tr>
<td>Value $ ('000)</td>
<td>110,904</td>
<td>27,618</td>
<td>46,063</td>
<td>50,674</td>
<td>95,585</td>
<td>178,064</td>
<td>258,607</td>
<td>784,497</td>
</tr>
</tbody>
</table>

**Source:** World Bank database- World Development Indicators

Kenya has experienced low and sharp fluctuations in FDI over the years. Figure 1.1 gives an outlook of how FDI in Kenya plummeted in 2001 and steadily picked up again from 2004 onwards after the country had recorded rising investment levels in the third and fourth decades after independence.

According to the Kenya national bureau of statistics (KNBS, 2014), the economy is still susceptible to external economic turbulence, which can grind down the significant milestone it has achieved. This external vulnerability can be hedged by increasing and encouraging both domestic and foreign savings. FDI flow to Kenya can be incentivized
through structural reforms that better business environment, and increase the rate of growth and savings (Ernst and Young, 2014). These reforms must involve tax and expenditure measures that increase both savings and investment so as to allow Kenya to take advantage of low labor costs, and its strategic coastal line location to expand and tap into manufacturing exports.

The government has over the years objectively designed economic policies with a main goal to rejuvenate private investment in the country. Fiscal policy has been a major focus towards this direction. Other strategies include the industrialization strategy, outlined in Sessional Paper no. 2, adopted by Parliament in 1996 aims to transform Kenya into a fully industrial state by 2020 (KPMG., 2012). The strategy stresses on underpinning export industries, propelled by a desire to grow their employment potential. Kenyan government’s long-term plan, Vision 2030, unveiled in 2007 as the roadmap to attaining middle income status as a nation by 2030. The Sessional Paper also recognizes industrial promotion as a growth and development avenue.

1.2 Statement of the Problem

Studies have been carried out on fiscal policy and foreign direct investment in different economic settings around the globe (Borensztein et al., 1998; Carkovic and Levine, 2002; and De Gregorio, 2003). Vermon, an economist in the 1960s had by then made the first move in acknowledging the significance of location as a control or decisive factor of FDI decision making process on a global scale. However, his conclusions differed on basis of various regions of the globe. But as the world started transforming into a global village, then interests on the aspect of FDI determinants and its flows was renewed. Sub-Saharan Africa (SSA) drew great interest on the fact that many foreign investors realized it as a good investment location, majorly because of its well endowed and not fully tapped natural resources.

Snyman and Saayman, (2009) investigated on the key factors influencing foreign direct investment in the tourism industry in South Africa. The study highlighted the main variables namely; infrastructure, government spending policy, economic performance and competitiveness. Havi and Attah-Obeng, (2013) using macroeconomic variables namely; public expenditure, interest rates, inflation and exchange rates also investigated the
impact on FDI in Ghana. Other than concentrating on countries with distinct attributes to those of Kenya, these studies did not take into account the effects of fiscal policy on FDI inflows and the variables too.

Ezeoha and Cattaneo, (2011) further outlined that empirical evidence supposed to have been used in guiding for policies to help increase FDI inflows in Africa is still very limited. However, previous studies reveal that fiscal policy has specific effects on FDI inflows to developing, transitioning, and developed economies respectively (Busse et al., 2006). Nyamwange, (2007) also agreed to this when his findings uncovered that the effects of fiscal policy variables on FDI inflows in other developing nations do not necessarily match with that of Kenya hence the need to conduct a study on Kenya.

This congruity signifies the necessity to take note of the prevalent fiscal policy aspects in most African nations with respect to their ability to attract more FDI inflows. Although UNCTAD’s World Investment Report (2004) reported that Africa’s outlook for FDI is promising, the expected surge is yet to be manifest. FDI is still concentrated in only a few countries for many reasons, ranging from negative image of the region, poor infrastructure, corruption and foreign exchange shortages, to unfriendly macroeconomic policy environments among others. The consensus in the literature appears to be that FDI spillovers depend on the host country’s capacity to absorb the foreign technology and the type of investment climate (Onyancha, 2006).

Finally, a country’s fiscal policy, an endogenous factor remains an integral tool to a country’s competitiveness for attracting FDI (Ernst and Young, 2014). Limited number of studies has been carried out in the country with reference to the fiscal policy and how it impacts on economic conditions of the country, the most recent but unpublished done by (Mbaye, 2012). The focus has largely been on the monetary and macroeconomic policy shocks on the economic growth of the country, which was more universal to the economy and not specific to foreign investors. Therefore, FDIs as private investment in Kenya never got much attention as it should have been yet it contributes a certain segment to our economic growth and development. Fiscal policy has been a major force towards this direction. This then forms part of my study in the next chapters to follow.
1.3 General Objective

The general objective of the study was to investigate the effects of fiscal policy on foreign direct investment inflows in Kenya for the period 2000 to 2014.

1.4 Research Objectives

The following are objectives of this study:

1.4.1 To determine the effect of Balance-of-Payments (Current Account Deficit) on foreign direct investment flows in Kenya.
1.4.2 To analyze the effect of government development expenditures (Infrastructure) on foreign direct investment flows in Kenya.
1.4.3 To determine the effect of total external government debt on foreign direct investment flows in Kenya.

1.5 Significance of the Study

The beneficiaries of this study are:

1.5.1 Central Bank (Policy Makers)

The Central Bank of Kenya through the monetary policy committee is charged with the responsibility of formulating policies that govern the supply of money in circulation, a system that will stimulate economic through regulation of inflation rate. This study will play a key role of providing some sense of direction to managing the supply of local currency and thereby encourage more foreign investments.

1.5.2 Government of Kenya (Treasury)

This research will aid the government through Treasury, in drawing up and devising economic policies and systems, specifically fiscal policy; that is aimed at stimulate the existence and sustenance of foreign direct investors in Kenya. It will empower them to become better in setting up and doing business locally consequently improving the
country’s attractiveness in terms of destination for investment. The study will also help in implementation of fiscal incentives that realize additional benefits than costs and hence trigger economic growth.

1.5.3 Scholars and Researchers

In addition, scholars and researchers will find this study useful if they wish to use the findings as a basis for current and further research on the subject. Availability of information and areas of study stimulate a lot of interest for scholars to advance in the field. This research paper will be available in libraries and most probably on the internet hence will be accessed by most scholars. Future scholars and researchers will gain tremendous professional benefits from expanded dissemination of this work.

1.6 Scope of the Study

The focal point of this study was fiscal policy and foreign direct investment net inflows to Kenya for the period 2000 to 2014. The 15 year period was all-inclusive to give basis for conducting an exhaustive research.
1.7 Definition of Terms

1.7.1 Foreign Direct Investment (FDI)

An investment made to gain a long term management interest in a business enterprise in a country other than that of the investor defined according to residency (World Bank, 1996).

1.7.2 Fiscal Policy

Measures on government spending that impact on macroeconomic conditions; affect tax rates, interest rates and government spending in an effort to control the economy (Sullivan, Arthur and Sheffrin, 2003).

1.7.3 Balance of Payments (BOP)

Accounts that record the receipts and payments of the residents of a country in their transactions with residents of other countries (IMF, 2005).

1.7.4 Open Market Operation (OMO)

The purchase and sale of securities in the open market by the central bank, as a way of implementing and regulating the monetary policy (Federal Reserve Bank., 2007).

1.7.5 Tax Harmonization

Making taxes identical or at least similar in a region. It is also an increase of tax in low-tax jurisdictions, rather than a reduction of tax in high-tax jurisdictions or both simultaneously (Quéréa, Trannoyb and Wolffic, 2014).

1.7.6 Tax Haven.

A country or independent area where taxes are levied at a low rate (OECD, 2001).
1.8 Chapter Summary

The chapter has introduced the research topic (Effects of Fiscal Policy on Foreign Direct Investment Inflows in Kenya for the period 2000 to 2014) by touching on a detailed background of the study. It has highlighted the main objectives too and stated rationale of conducting the study. The next chapter will be the literature review based on the research objectives and; followed by the methodology of collecting data and analyzing them; then followed by research design and methodology, chapter three, while results and finding are presented in chapter four. The last chapter provides the summary, discussion, conclusion and further recommendations.
CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

Chapter two has addressed a theoretical, detailed analysis on effects of fiscal policy on FDIs in the Kenya and presented a review of relevant literature on the effect of fiscal policy to FDIs. It has also scrutinized various findings and conclusions on other studies done in the previous years on the effects of various taxes, public expenditure, government debt servicing, and balance of payment on the level of foreign direct investment inflows in the country. The discoveries are theoretical and thus of empirical nature.

2.2 The Effect of Balance-of-Payments (Current Account deficit) on FDI

Foreign direct investment has been regarded as a key accelerator of economic growth in developing nations (Ghurra and Goodwin, 2000). According to UNCTAD’s World Investment Report (2004), world saving as a percentage of world’s income has dropped over the last decades. Consequently, interest rates have been on the decline causing world inflating rate to rise. With this backdrop, foreign direct investment (FDI) has increasingly turned out to be attractive to third world countries servicing costly foreign debt and experiencing decreasing domestic investment. Foreign direct investment is favorable and expanding sources of finance that developing countries may rely on to close the gap with developed nations (World Bank, 2003). This could justify why FDI has doubled over the last decade. Nevertheless, it is observable that the soaring current account deficits is one of the least preferred macro problem of large capital inflows like FDI (Meyer, 2003). Developing nations generally experience current account deficit problems and the international capital streams to developing nations have coincided with expanding deficit in current account in most of these nations (Calvo et al., 1996).

According to the IMF, Kenya’s deficit in her current account has been severely overestimated, particularly in the years 2012 and 2013. The country recorded a widening gap in the current account deficit according to official figures with a jump of 7.3% of GDP in 2010 to 9.7% of GDP in the subsequent year, and even further to 11.2% of GDP.
in 2012. Nonetheless, in December 2013, the IMF reported that this is at odds with an appreciation of the real effective exchange rate in the region of 5% - 10%.

The KNBS on the other hand is working on revising balance of payments statistics. Despite the figures being provisional and subject to review, the current account deficit narrowed from $3.9bn (9.5% of GDP) in 2012 to $3.7bn (8.4% of GDP) in 2013. It is also observed that exports to East African counterparts, Tanzania and Uganda who are the largest buyers of Kenyan goods have been on a diminishing trend since 2011 on what is majorly attribute to a vibrant manufacturing sector in the east African countries and local firms opening shop in Kampala and Dar es Salaam.

Balance of payments problems arise gradually and may culminate from occurrences like escalating loss of major export markets, soaring competition in the domestic market from low-cost imports, unsustainable deficits in the current account, increasing external or foreign borrowing, over dependency on imports and diminishing capital inflows (Higgins and Klitgaard, 1998). These problems may turn severe in situations where borrowing from foreign sources is cut-off and international reserves turn out to be so scarce that they cannot buffer import and export instability or drops in net capital inflow.

Soaring current account deficits are often an antecedent to difficulties in balance of payments. The current account balances, often perceived by many as a complex economic theory (Higgins and Klitgaard, 1998). Economies consuming more than they are generating through running large deficits, the current account connects international and national economics. United States and China accused each other on trade imbalances a situation that saw the two superpowers face repercussions for the international financial system where some nations observe huge and persistent current account deficits while others amass enormous surpluses (Ghosh and Ramakrishnan, 2012).

Funding current account deficit just like foreign direct investment (FDI) is a comprehensive quantifier of the trade deficit demands capital inflows, a drawdown on a nation’s reserve (usually in foreign currency) or other net currency inflows (Higgins and Klitgaard, 1998). Similar to most developing countries who often have limited savings (public and private) relative to investment needs, some Pacific island microstates observe high dependency on imports outrunning their capacities to export. These savings-and-
capital-poor nations more often face difficulty in financing current account deficits if foreign currency inflows are impeded or suspended (Ghosh and Ramakrishnan, 2012). Escalation in foreign debt and increase in current account deficits may compel a nation to rely more on foreign aid flows to make up for deficient domestic savings and to sustain living standards for its citizens.

Moreover, economic shocks, both internally and externally may lead to financing difficulties and consequently resulting to reducing foreign direct investment inflows, exports, tourist receipts and foreign remittances; unfavorably affecting domestic savings and in the long run pushing for increased imports (Davis and Lester, 1996). These situations result to decreased credit rating marked by an increased sovereign risk hence limiting government borrowing leverage from private sources or other governments. In these circumstances, the capacity of governments to increase foreign currency borrowings from usually diminishes (and borrowing costs escalate) as credit ratings decline and sovereign risk increases.

Akbas et al., (2013), analyzed various countries for the period 1990 and 2011 to establish the link between foreign direct investment (FDI), current account deficit, GDP, and total credits of G7. The research factored the cross-sectional dependence and was employed to determine the causality among the variables form the panel. With application of the panel unit root techniques, it was established that GDP and foreign direct investment have a static composition with total credits and current account deficit comprising unit root.

Co-integration technique was also administered to determine if a long-term relationship exists among the variables or not. The test exhibited a co-integration link between the series. A causality test advanced by Dumitrescu and Hurlin, (2012) was also applied to find out the probability of a causal connection between the variables. The comprehensive findings of the analysis evidenced a unidirectional causal relation from current account deficit and foreign direct investment to GDP. However, a unidirectional relationship manifested from foreign direct investment to current account deficit and total credits.

Agosin and Mayer, (2000) observed that the extent of monetary policy decisions get limited by the obligation to protect a country’s foreign reserves as balance of payments difficulties escalate. The restriction on importation and foreign exchange controls as a
short term precaution may encourage local savings for domestic use while safe guarding foreign reserves and exchange rate (Imam, 2010). This, in turn diverts pressure off the need for a major monetary policy adjustment. Nevertheless, confrontational and intense long-term measures are ordinarily a misfit as they could discourage foreign direct investment as a consequence of reduced business confidence, infrastructure run downs and stringent government controls on imports leading to currency inconvertibility. Other likely implications on capital, import, foreign exchange controls and capital comprise economic inefficiency, gradual drop in economic activities, and deterioration in the standards of living as a result of poverty (IMF, 2009).

A number of studies on the global financial crisis have been conducted and currently relatively large literature exits (e.g. Krugman, 2008; Kilonzo, 2008; Senbet, 2008). To facilitate economic growth, governments are charged with the obligation to ensuring efficient and effective resource allocation, market regulation, stabilization of the economy, and harmonization of social conflicts (M’Amanja and Morrissey, 2005). Solomon Islands and Fiji felt the global crisis effects from 2008, encountering tremendous current account deficits of around 18 percent of GDP amid Pacific island nations (Heyzer, 2009). The empirical analysis indicates that the adverse effects global financial crisis has overall increased the intensity of central bank communication on fiscal policy (Allard et al., 2010).

The effect of the global economic recession especially on foreign currency earnings aggravated and exposed deficiency in the balance of payments of Solomon Islands and Fiji. Despite several governments around the globe undertaking a significant fiscal impulse to boost economic activity Fiji’s terms-of-trade continuously declined since 2003 (IMF, 2010). Fiji, depending majorly on revenues from exporting sugar substantially lost EU trade (price) preferences because some local sugar mills became dysfunctional and loss-making. Sugar exports historically experienced a plunge while the garment industry headed the same direction as a result of World Trade Organization requirements. Gold exports and tourism receipts equally dropped and remittances diminished significantly in 2008 (IMF, 2009).

Increased economic unpredictability coupled with the 2006 coup d’état, the institution of unprecedented controls and inception of subsequent denigrated credit detracted from
deficient competitiveness and the unattractiveness of Fiji for foreign direct investment and tourism (Reserve Bank of Fiji, 2008). Foreign investment in Fiji has been negatively affected witnessing a tremendous drop in the number of foreign investment registrations from 441 in 2006 to a record 245 in 2008. This represents a 55% decline, an equivalent of around FJ$600 million worth of probable foreign investments (IMF, 2009).

Solomon Islands on the other hand had her currency pegged on the US dollar and consequently depreciation of the US dollar adversely affected her economy. Similarly, the foreign currency reserves of Solomon Islands were negatively impacted when the US dollar appreciated in 2008 and while the revaluation outcomes caused significant drop in value of non-US dollar denominated holdings. Heightened economic uncertainty triggered massive profit repatriation by foreign-owned companies and private capital inflow fell significantly. The current account deficit was marked by a rise of 10 percent (from 20 per cent of GDP in 2009 to more than 30 per cent of GDP in 2010) resulting to a crisis on the national budget (IMF, 2010).

Current Account Deficit is a big problem that India experiences (Hossain, 2008). India, since 1991 has taken initiative to bring economic change by use of a liberal and competitive approach in reviewing economic policies and reforms in an effort to resolve this persisting problem. More so, transformation in the political climate has accelerated India’s attractiveness for FDI. Kaur, Yadav and Gautam, (2012) examined the relationship between Current Account Deficit and Foreign Direct Investment (FDI) in India. The researchers analyzed data for the period 1975-2009 and applied the Toda-Yamamoto (T-Y) granger causality method. The findings of the research exhibited a blend between current account and FDI in the long run. A corroboration of unidirectional causality exists from current account to FDI. Additionally, an examination of key components of current account, exports and imports which are also a part of FDI and international Trade endorsed the findings.

Siddiqui, Ahmad and Asim, (2013) examined the link between current account and FDI in an empirical investigation for Pakistan economy. Using the Granger causality test and also application of Johansen-Juselius cointegration approach the research revealed that Foreign Direct Investment and Current Account are cointegrated and confirmed a relative long run connection. The Granger causality test results expressed uni-directional causality
between FDI and CA. Nonetheless, no short run causality was observed to be existing from FDI to CA and contrariwise.

Ravi and Surendra, (2014) Nations face various Macro problems that they have to often tackle. The problems in most cases are interconnected but each may become an issue of concern at different times. With no common fix to these problems nations have to act with consideration of the existing conditions. For instance, prevalence of a current account deficit (CAD) calls for a numbers of actions to maintain it at a manageable level. Soaring levels of CAD have two possibilities. The affected country can bridge the gap by using up its foreign exchange reserves, a hazardous approach because it is not sustainable as the currency may become exposed. This will rightly impact negatively on a country’s attractiveness for FDI. The other alternative is a move to incentivize and attracts substantial capital inflows through foreign direct investment (FDI) to provide a buffer to mitigate CAD (Ahmad et al., 2004). However, the potency of FDI inflows as a means to fix CAD is not guaranteed. The reverse is equally likely.

2.3 The Effect of Government Development Expenditures on FDI

There is extensive literature probing the effect of public expenditures on economic growth. Being one of the government’s instruments together with taxation and welfare policy, public expenditures are asserted as “the most powerful economic agent in all modern societies” (Arrow and Kurz, 2007). While government consumption has a negative effect on economic growth, as presumed by a number of economists, government investment is regarded as one of its key beneficial components (Gupta et al., 2002; and Turnovsky, 2004). In contrast, many others claim a negative correlation between economic growth and government spending or find a tenuous bond between these two components (Folster and Henrekson, 2001).

In 1999, after broadening the IMF’s concessional lending to include an explicit focus on poverty reduction in the context of growth oriented strategy, the World Bank and IMF relayed structural adjustment programs (SAPs) to many developing countries causing great discourse in the fiscal policy field. SAPs are massively dependent on public investment and are aimed at improving the government’s current cash flow position but at
the expense of future economic growth (Ley, 2009). The key factor that came to picture; crucial in determining government size, is the efficiency of government expenditure.

Government expenditure is an arbitrating approach that most if not all governments use to not only recoup on non-performing competitive markets but also securing equity in allocation (Ke-Young and Hermming, 1991). In their study, Ke-Young and Hermming observed that notwithstanding economists taking cognizance of its two-side effects in stimulating economic development, public expenditure is looked upon as a vital agent for a government to monitor and regulate economic developments. They also noted that public investment is an ingredient to providing capital accumulation. Public expenditures are also used in the market economy to bridge any prevailing gaps such as public utilities, health care and social security. On the other hand, tax forms almost the overall source of finance for government expenditures. It is conventional that government expenditure and growth aid in sustaining a country’s attractiveness for FDI.

Zhang, (2001) asserts FDI growth depends on the quality of the environment of the recipient country. Furthermore, government expenditure and foreign direct investment (FDI) are key macroeconomic factors of any economy as they are strong propellants of economic development. According to Caves (1996), the rationale for increased efforts to attract more FDI stems from the belief that FDI has several positive effects. He also observed that while public expenditure issues remain increasingly important in the context of both stabilization and structural adjustment initiatives, FDI has boosted growth and development of many host countries. This is by way of improving their technical skill-sets, entrepreneur abilities, infrastructure and financial resources in terms of government revenue and foreign exchange.

In a study by Vuale and Suruga, (2005) analyzed the effects of public expenditure on FDI and the rate of economic growth. Their research provided a confirmation that an excess appropriation in public expenditures can hamper the beneficial FDI. The same study, after examining other potential relationships between public expenditure and FDI recommended that more efforts towards establishing a theoretical model that exhibits the correlation between factors that contribute to determining the long-term economic growth rate.
An analysis of the relationship between FDI levels, degrees of economic development and government expenditures especially capital and recurrent expenditure like interest on loans, roads, industry, education, transport, agriculture etc in third world countries is significant. These variables tend considerably contribute to growth (World Bank, 1994). Ahuja, (2013) advanced the use of government expenditure in sustaining aggregate macroeconomic stability. He posited that overall demand can be increased by government expenditure and consequently enhance economic development which in the long run boost FDI levels. Ahuja further maintained that escalation in government development expenditures tag along with a multiplier effect on the national earning resulting to a more than proportionate increase in the national earning. The findings of his study also revealed that the variation in government expending not only secures a steady economy, but also precipitates and stimulates economic development and attract FDI. Nonetheless, surplus government expenditures in many developing nations have steered to soaring budget deficit and occurrences of debt difficulty.

According to Ajudua and Davis (2015), vital macroeconomic variables; government expenditure and Foreign Direct Investment (FDI) are strong drivers of economic development of a nation. Their study, which sought to ascertain the effect of government expenditure and FDI towards Nigeria’s economic development, was necessitated by the need to control government spending and monitoring the FDI so as to achieve a steady economic growth necessitated this study. Multiple regression analysis was applied to examine the correlation between government expenditure (capital and recurrent expenditure) and FDI as the explanatory variables on GDP (proxy for economic growth) as the dependent variable. The findings of the study exhibited that the explanatory variables: capital and recurrent expenditures and FDI had a notable relation with economic growth. However capital expenditures did not conform to expectation (Ajudua and Davis, 2015).

Bose et al., (2003) investigated the effect of government expenditure examining economies of thirty developing countries over the decades of the 1970s and 1980s, focusing on expenditures of various sectors. The findings indicated a positive and significant correlation between the share of government capital expenditure in GDP and economic growth. However, current expenditure was observed to be insignificant. Furthermore, the only spending that is consequentially connected with growth once the
budget constraint and omitted variables are taken into consideration is at the sectorial level, government investment and total outlays in education.

Fiscal policy, holistically, and particularly government spending may provide for development of the economy (Borensztein et al., 1998). Although with a possibility of crowding out private investment by elevating investment level over the equilibrium level of the economy, government spending on public investment in infrastructure increases the productivity of private capital is heightened and consequently stimulated private investment (African Development Bank Group, 2014).

In his study, Mamatzakis, (2001) noted a positive correlation between public investment and private investment whilst government expending had a contrary effect on private investment. He explored whether a relationship exists between disaggregated measures of government expenditures and private investment in Greece. Mamatzakis applied a co-integration analysis of a multivariate system of equations so as to empirically determine the long run connection between private investment and government expenditures at different measures. Despite the inquiry maintaining that when the effectiveness of fiscal expenditures is assessed, it was observed that different components of public spending be looked. However, government investment was discovered to affect private investment positively. In contrary, government consumption was noted to rival government investment for the same resources while consequently affecting private investment negatively.

Various studies on the connection between government spending and private investment do not take into account the relationship between government final consumption expenditure (domestic credit) and private investment (foreign direct investment) in their reviews (Akinlo, 2004). In addition to Mamatzakis (2001), Nurudeen and Usman, (2010) explored the link between the elemental aspects of government spending and FDI in Nigeria for the period 1981 to 2010. For a while now, government’s role in stimulating economic growth and development has been a debatable issue since Keynes came to light in the 1930s. Proponents of fiscal policy argued that Government expenditure through the effect of increasing tax on firm and individual may impede economic growth. Such increase in individual and firm tax reduces aggregate demand and reduces profitability as
well as investment of firms. Consequently, this negatively affects potential investment and economic development in the long run (Blejer & Khan, 1984).

Opponents of fiscal policy on the other hand contend that if government funds it spending by means of bank borrowings, then expenditure may affect private investment negatively. Consequently, such bank borrowings result to an increase in interest rates which in the long run affect the cost of capital for the private sector from banks. High costs of borrowing leads to crowding out (compete away) private investment with adverse affect on economic growth. This broad study, using an error correction modeling procedure disclosed that the elements of public expenditure have differing effects on FDI in short and long run. Particularly, recurrent and government ultimate consumption expenditure had positive (crowd-in) effect on private investment while capital expenditure had negative (crowd-out) effect on private investment. The investigation therefore proposed that more emphasis should be placed on capital expenditure.

2.4 The Effect of Total External Government Debt on FDI inflows

According to UNCTAD (2004), FDI is an important source of economic growth and development in most developing nations as it notably boosts growth in capital accumulation and national income. Furthermore, FDI flows are regarded as the most ideal type of capital flow contrasted to portfolio investments because they are a more steady form of investment than financial investment flows (Lipsey, 2001).

Demirhan and Masca, (2008) mentioned one of the main economic hiccups that developing countries face is not having enough national savings to finance their investments. Most developing nations are in unceasing need of foreign capital in forms of both direct and indirect investments. Initially, they took loans from international commercial banks. However, the 1980s drying-up of commercial bank lending resulting from debt crises pushed a number of nations to revise their investment policies and strategies so as to attract more steady forms of foreign capital (Agiomirgianakis et al., 2003). FDI somehow seemed to be one of the unchallenging forms of getting foreign capital without shouldering any risks linked to the debt. Thus, it turned into an attractive alternate to bank loans as a source of capital inflows.
According to the Debt Sustainability Analysis (DSA, 2011); an appendage in country report No. 12/14, Kenya’s debt standpoint has strengthened. Despite the frail than anticipated economic growth, all debt indicators have progressed as a result of reduced fiscal and current account deficits in financial years 2011 and 2012, and more favorable exchange rate developments. The country’s risk of external debt adversity remains at lowly manageable level and also general public sector debt dynamics are continuously sustainable. Furthermore, Kenya’s external debt burden indicators, according to stress tests and the baseline scenario do not infringe any of the pertinent policy-dependent thresholds.

Azam and Khan (2011) investigated, using a quantitative approach, the effect of public debt on foreign direct investment in Pakistan. The two researchers observed that, specifically for developing nations, FDI is crucial for the economic growth as its ripple effect ushers not only financial reinforcement to the host nation but also support in technological advancements, capital, job opportunities, skill development and management and expertise.

FDI is regarded as a prime harbor of private external inflows for developing countries worldwide and obviously, employment opportunities will be created by intensifying investment in developmental projects more (Azam and Khan, 2011). Less developed nations like Pakistan envisioned to bridging the gap between savings and investment by use of FDI as a tool. FDI has resolved the over multiplied debt issue of less developed nations and aided in financing development initiatives which in the long run stimulates increase of per capita income of the country (Husnain et al., 2011).

Pakistan, with total FDI inflows recorded at US$ 3205.4 million during 2008-09 as contrasted to US$ 3719.1 million in 2006-07 shows a slump of 13.8% (Ahmad et al., 2004). Similarly, the country’s total public debt estimated at US$ 39593 million in the financial year 2007-08 and such as during 2006-07 per capita debt in Pakistan was US$ 247 million (IMF, 2010). Secondary data for the period 1981 to 2007 was examined for practical evaluation while employing the simple log linear regression model and the least squares method. Empirical findings of the study showed that public debt discourages FDI inflows into Pakistan and therefore recommended for a proper management of public debt.
sensitized through a proactive debt management policy for purposes of maximizing FDI benefits in Pakistan.

Public borrowing, a major macroeconomic indicator for a country’s rating in global markets is an unavoidable occurrence especially for developing countries that have to stimulate growth by pumping capital into the economy (Demirhan and Masca, 2008). It is one of the inward foreign direct investment flow determinants. Ribeiro, Vaicekauskas and Lakštutiene, (2012) established that public debt affects FDI differently, varying from country to country and is triggered by a number of factors. In their study on how various macroeconomic indicators affect GDP with special emphasis on debt related predictors, they applied a multiple linear regression model. Interesting findings were achieved regarding economy openness and foreign direct investment. The outcome of the inquiry affirmed that a country’s determinants influenced the efficiency of public borrowing and its effect on FDI. However, no correlation was observed between debt crisis, level of government debt and how it impacts on GDP. Private borrowing, on the other hand, indicated a positive effect on the economy in every country where it resulted statistically significant.

Richards, Nwanna and Nwankwo, (2003) analyzed African market dynamism, its attractiveness to FDI and how debt burden and corruption affects these markets. The research marked that huge debt burdens, other than crippling economic growth and development, it also sabotages economic recovery efforts and market-enhancing schemes in many developing nations. This is a problem majorly faced by African countries and hence Africa being the world’s most aid-dependent and indebted region.

Regrettably, the conventional perception for puzzle solving, the cliché and supposedly tired mantra: capacity building through investing in human capital, advancing infrastructure, liberalizing foreign trade, economic integration in various trade blocks, developing policies to good governance and market access (Calamitsis, 2001). These prerequisites including development of sound systems in the financial sector, provision fiscal incentives and mitigating controls on inflows and profit remittances among others are supposed to make countries more attractive for foreign investments have been unrealizable.
According to the World Bank (2001), many African nations are well endowed with resources but much of it is put to servicing debts instead of national revenue generation projects. A total of 44 countries are categorized as “heavily indebted poor countries” (HIPC) and 33 of these are African countries. For instance, in 2000, all developing nations’ borrowings totaled to $246 billion with $214 billion channeled back to creditors to offset loan arrangements. This essentially implies that developing nations had to find a $135 billion deficit to take care of interest on old loans, meaning a net transfer to the creditor countries of $103 billion. Similarly, in 2000, Sub Sahara Africa (SSA) took up $11 billion in borrowings but repaid $15 billion ($10 billion in principal repayments and $5 billion in interest payments).

Consequently, close to half of the $10 billion aided to SSA the same year was held back in Europe and USA to help repay old debts and at close of 1998, annual debt service payments amounted to $15.2 billion (World Bank, 2001). Indeed, currently the total debt of SSA stands at over $231 billion. As a result, their economic and social welfare systems, infrastructure and other investment incentives keep deteriorating that societal good and regeneration, a concept of government as an instrument of has become useless. Some African countries, in the long run lose out on Foreign Direct Investment inflows. Zambia is in a similar situation, with annual repayment of $222 million and an education budget of only $95 million” (Owusu et al., 2000).

Adegbite et al., (2008) investigated the effect of external debt burden on Nigeria’s economy by exploring the applicability of the “crowding out” and “debt overhang” theory effect. Nigeria, a third world country relies considerably on external financing in form of loans to fund her development projects like most developing nations. The magnitude of these loans was small in early years but gradually precipitated to a crisis worsened over the years. The 1978 “jumbo loan” alone approximated at US $1 billion and within the next four years (1982) Nigeria's external debt hit a high of US $18.631 billion typifying over 160 percent of Nigeria's gross domestic product (GDP) for that year (World bank, 2004).

According to Ayadi et al. (2003), Nigeria is incapacitated from playing a major role in World economy as a result of external debt burden and her indebtedness continually and indirectly affects employment, literacy and poverty levels. This gradually manifests as an
impediment to FDI and a hindrance to economic growth and development. Most developing nations are characterized deficient internal capital formation due to the vicious circle of low productivity, low income, and low savings (Muzammil et al., 2013). The situation calls for external support; managerial and financial.

Consequently these countries opt for external debt as a means of financing capital formation (Adepoju et al. 2007). Unfortunately external debt accumulates owing to the fact that some servicing requirements turn out to be too stringent. In this backdrop, external debt becomes a self-sustaining process of poverty aggravation and an impediment on development in growing economies hence unattractive for FDI (Agosin and Mayer, 2000).
2.5 Chapter Summary

Kenya, which is increasingly becoming a favored business hub, not only for oil and gas exploration, but also for manufacturing, transport and the booming technology industry has a potential to grow foreign direct investment to higher levels by renewing investor interest and confidence in the country’s business climate. In a world of increased international capital mobility and particularly in integrated markets, investors will always search for ideal business environments that are incentivized. Kenya can achieve this through a steady and well managed fiscal policy that encourages FDI and does not impact on foreign direct investment negatively.

Chapter three provided the research design, data collection and analysis techniques for the study.
CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction

Chapter three presents the overview of research methodology to be used in the study and gives procedures used to carry out the research work. The discourse in this chapter is structured around the research design, sampling of population under study, data collection methods, analysis and presentation of findings. Ethical considerations and measures to provide trustworthiness are also presented.

3.2 Research Design

This investigation focused on effect of fiscal policies on foreign direct investment in Kenya and therefore was a descriptive study. A research design is a conceptual framework within which a research would be conducted. According to Calderon and Gonzales (2012), a research design involves establishing and stating the general research approach or strategy adopted for the particular project. It is the basis of planning. The research design should adhere to the research objectives. Calmorin, (2010) defined research design as the specification of techniques and methodologies for acquiring the information required. It is a detailed outline on how the research will take place. It presents an over-all operational framework of the project that specifies what information is to be collected from which source by in what form and procedures.

A descriptive research design of quantitative method of data was adopted in this study. Descriptive research is a statistical method that involves surveys and fact-finding enquiries of different kinds (Calderon and Gonzales, 2012). The key role of descriptive research is describing the state of affairs as it exists at present through quantitatively synthesizing the empirical evidence of a specific field of research. This study investigated the effects of fiscal policy on Foreign Direct Investment inflows in Kenya for the period 2000 through to 2014. Consequently, the research design that was used was correlation design and a linear regression model. Correlation aids in analyzing a relationship between two or more variables (Cooper and Schindler, 2003).
The variables under study fell on either dependent or independent class and therefore the research design used was fitting in ascertaining the correlation between the variables. The correlation characterized and elaborated the specific study objectives comprehensively. Simple linear regression model and correlation are commonly methods in statistics to explore the link between variables in developmental studies. The two techniques are favored by many researchers because they are fairly easy to apply and in most cases give an almost accurate between the variables under study.

### 3.3 Population and Sampling Design

#### 3.3.1 Population

A population is the entire pool from which a statistical sample is drawn and population usually has some common observable characteristics (Calmorin, 2010). The research was based on the effects of fiscal policies on FDI flows in Kenya, thus the population consisted of the entire performance and FDI data for the period of 2000 to 2014. Specifically, the population comprised of the actual FDI inflows to GDP net value, Tax Rates, Development Expenditure (Infrastructure), and Debt of the country for the period under investigation. The population covering the period is huge considering regular variations in the determinant variables. The studies then narrows down to a period of 2002 to 2013, thus a total of 14 observations were made for each of the four variables.

#### 3.3.2 Sampling Design

##### 3.3.2.1 Sampling Frame

A sampling frame is an inventory that a researcher uses to describe his /her population of interest. According to Denscombe (2010), a sampling frame should comprise a comprehensively updated inventory of all that comprise the population for the research. A Sampling frame gives a clear definition of the set of elements from which a researcher can select a sample of the target population.
3.3.2.2 Sampling Technique

Sampling technique plays a crucial role in diverse problem solving and because one sampling technique may not be suitable for all problems, specific sampling techniques are applied for different scenarios. Choosing the most appropriate sampling technique is equally critical so as to obtain an accurate representation (Saunders et al., 2013). With the use of non-probability technique, the study specifically applied a judgmental sampling over purposive sampling while using the most recent secondary data available in Kenya.

3.3.2.3 Sampling Size

Saunders, Lewis and Thornhill, (2011) highlighted that statistical probability determines generalizations about populations from data collected using any probability sample. A larger sample size is associated with a lesser likelihood of errors hence a higher accuracy level. However, Probability sampling is therefore a concession between the accuracy of outcome and the available time and money to facilitate collecting, checking and data analysis. The level of certainty on quality of the data collected will depict the characteristics of the total population based on the margin of error; the types of analyses to undertake; the size of the total population from which your sample is being drawn.

The sample size of all variables was extracted from the time span under review; 2000 through to 2014. The period is reasonably extensive to evidence the effect of fiscal policy on the foreign direct investment flows in Kenya. The data collected showing FDI inflows is from Kenya National Bureau of Statistics (KNBS), The World Bank Database. Additional data on variables reviewed was drawn from various periodical issues and reports of Central Bank of Kenya (CBK), The Kenya Investment Authority (KenInvest), Government Finance Statistics Yearbook and International Monetary Fund.

3.4 Data Collection Methods

Secondary data was used in this study as it is abundant to provide an exhaustive analysis on effects of fiscal policy on FDI inflows since the area of study is not new and various researches have previously been conducted on. The various sources of data included; Nairobi Securities Exchange (NSE) database, approved economic reports, publications, publicly available sources such as websites and historic data. Two checklists were used to
draw information relevant for the study. Checklist one was designed to focused on the specific independent variables; tax rates, government expenditure (on infrastructure), and debt while checklist two captured information on the dependent variable; foreign direct investment inflows in value and as an aggregate to the real Gross Domestic Product (GDP). (See: Appendix).

3.5 Research Procedures

From the onset, it was determined that this study will utilize secondary data only. The first step therefore was identifying the sources and finding the necessary data. The second research procedure was appraising of the identified information. The various sources of secondary data were vetted to ascertain a high measure of rationale and authenticity. This appraisal embraced the critical interrogation of, among others theoretical and conceptual models applied in the sources, variables considered, proposition put forth, functional definitions used, the measures used and control procedures deployed in the secondary studies.

After data assessment, validation was carried out. This necessitated reaffirming that all the data sources used had; the essential documentation and deployed the proper coding, variables and that the stats in them were not replicable. On basis of the secondary data, the regression model to be used was formed and expressed in form of regression equations. The intrinsic usefulness of this model in testing and envisaging the values of the dependent variable given the independent variables was also probed using various methodologies like the coefficient of determination; ‘R’ squared, the standard error and the ‘F’ statistic. The regression model was then to ascertain the state and direction of the relationship between the independent and dependent variable. Experiments of statistical significance and measures of connection were analyzed and related to the study objectives after which the necessary conclusions were drawn.

3.6 Data Analysis Methods

Data analysis involves use of logical analytical tools to examine data collected for research purposes to generate summaries, observe trends and or patterns with the aim of making inferences so as to draw informed conclusions (Cooper and Schindler, 2003).
Data analysis was aided by use of Statistical Package for Social Science (SPSS). Descriptive and inferential stats were used where correlation and regression methodology was applied to establish the connection between fiscal policy and FDI inflows in Kenya for the period under investigation (2000 to 2014). The standard deviation (SD) and mean and were also encompassed in the analysis.

The package facilitated addressing the study objectives comprehensively. Other than being systematic, SPSS helped to address the entire analytical process, from planning and data collection to analysis, reporting and deployment. The observable patterns of FDI inflow were analyzed and contrasted with the fiscal policy variables; exchange rates, tax rates, government expenditure (on infrastructure), and debt aided by use of Microsoft Excel.

Correlation coefficient and linear regression model was applied to determine the direction and magnitude of the relationship between the independent and dependent variables. Interpretation of matching findings was tagged as:

- \( P = 1 \), indicates that there is a positive correlation,
- \( P = -1 \), indicates that a perfect negative correlation,
- \( P = 0 \), indicates no clear linear relationship between the two variables.

Where the greater the absolute value of a correlation coefficient, the stronger the linear relationship.

Regression analysis, a statistical methodology aided in estimating the strength and provided direction of the relationship between the variables (dependent and independent). The method was based on a model that is used to discover an advantageous linear relationship or bond between two variables which are then used to envision an unknown variable. A regression equation is always used to predict the above mentioned kind of relationship (Dudovskiy, 2012). The regression equation is as below:

\[
Y = B_0 + B_1X
\]

Where, \( Y \) is the dependent variable; \( X \) is the independent variable; \( B_0 \) is the value of \( Y \) in absence of \( X \); \( B_1 \) is the change in the value of \( Y \) with every unit change in the value of \( X \).
3.7 Chapter Summary

This chapter expressively presents the research methodology, procedures and design on this descriptive study and analyzing data with regards to the research objectives highlighted in the first chapter. The sources of data for this investigation, and as earlier stated in this chapter are Kenya National Bureau of Statistics (KNBS), The World Bank Database with additional data from Central Bank of Kenya (CBK), The Kenya Investment Authority (KenInvest), Government Finance Statistics Yearbook and International Monetary Fund (IMF). The following chapter exhibits the research findings and results.
4.0 RESULTS AND FINDINGS

4.1 Introduction

This chapter presents results of the study whose fundamental cause is to establish the extent to which fiscal policy impacts on the foreign direct investment (FDI) inflows in Kenya. The research relied majorly on secondary data, as stated in chapter three. Correlation and regression of the collected data collected was purposed to check the connection between specific fiscal policy variables and FDI inflows. Collected data for analysis has been presented on a table (captured in the appendix).

4.2 Observable General Trends

4.2.1 FDI Net Inflows

Figure 4.1 and 4.2 below show that the country recorded the highest FDI inflows to GDP in 2007 and the lowest in the year 2001. The massive oil and gas exploration in the Kenya, in addition to betterment in infrastructure and steady economic developments played a key role to this result. Over time, since 2000 to 2014 the country has observed an oscillating trend, with a major slump in 2008 after a soaring mark in 2007; the slump being attributed to political instability as a result of post-election violence experienced in the country. FDI inflows to GDP in the country started rising steadily from 2009, with 2013 recording the highest amount of inflows; however not as pleasing a result as one recorded in 2007.
Figure 4.1; Foreign Direct Investment Inflows as a percentage of GDP in Kenya (World Economic Indicators, 2014)

Figure 4.2; Foreign Direct Investment Inflows in Kenya (World Economic Indicators, 2014)
Table 4.1; Descriptive data on FDI inflows in Kenya

<table>
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<th>Minimum</th>
<th>Maximum</th>
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<tr>
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<td>15</td>
<td>2000</td>
</tr>
<tr>
<td>FDI Inflows net of GDP</td>
<td>15</td>
<td>.11290</td>
</tr>
<tr>
<td>Valid N (List wise)</td>
<td>15</td>
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</tbody>
</table>

A further analysis of descriptive data on FDI inflows to the country for the period under study evidenced a mean average of 0.05541 (5.5%) on FDI inflows to GDP, a median of 0.03474 (3.5%) with an approximated standard deviation of 0.05702 (5.7%) as depicted in table 4.2 below. This represents notable variances in FDI inflows in the country for the period under study.

Table 4.2; Descriptive data on FDI inflows in Kenya

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<th>N</th>
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<td>Missing</td>
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<td>Median</td>
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<td>.1021</td>
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<tr>
<td>Std. Deviation</td>
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<td>.057020532</td>
</tr>
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</table>
4.2.2 Balance of Payment (Current Account Deficit)

The Current account balance as a percent of GDP provides an indication on the level of international competitiveness of a country (World Economic Indicators, 2014). It was however projected that the sizable trade deficit would in part be offset by projected increases in the services and current transfer balances. This was attributed to the anticipated rising remittances (including revisions to the classification of the receipts), a recovery in tourism, introduction of new service categories, and growth in trade with developing economies within the East African region.

Figure 4.3; Kenya’s Export vs. Import for the years 2013, 2014 and 2015 (KNBS, 2014)
4.2.3 Development expenditure (Infrastructure)

According to the Kenya Public Expenditure Review (PER), Kenya is progressively on track despite unfolding fiscal pressure. The government through its flagship projects like expansion of Jomo Kenyatta International Airport (JKIA) and the Standard Gauge Rail has in a big way invested in infrastructure.

Figure 4.4; Kenya’s Current Account & Budget Balance as a percentage of GDP (KNBS, 2014)

Figure 4.5; Kenya’s Competitiveness Index (World Economic Indicators, 2015)
Despite of the government enterprise raising its budgetary allocations, a move whose implication is increased expenditure; the current state shows that the country’s global competitiveness is still frail according to figure 4.5. Kenya scored an average of 3.8 points out of a possible seven across 114 indicators that from education, macroeconomic stability, labor, institutions and infrastructure among many others (Global Competitive Index-GCI, 2014-15). This average score is attributed to corruption, cited as the most problematic factor; weak institutions in government; high corporate taxes and an overall infrastructure deficit. The infrastructure deficit is majorly pegged to the rate of executing these projects under infrastructure which currently stands at around 63 percent, which is the lowest compared with other sectors (KNBS, 2014).

4.2.4 External Government Debt

According to IMF, Kenya’s overall net public debt-to GDP-ratio has over the last two years reduced. This is pinned on the well advised fiscal policy and prevailing steady macroeconomic environment. The ratio stood at 43 percent at close of the year 2012, a drop from 48 percent at recorded at end of the year 2011. Although the country’s commercial component on external debt has increased, most of it is on concessional terms with overall public debt spread almost equally to domestic and external creditors.

Despite a drop in relative share has been marked since 2011, multilateral agreements have for a long time been Kenya’s source of credit eternally and at close of the year ending 2012, nominal public external debt stood at 23 percent of GDP; an equivalent of USD 9.1 billion. This ratio low contrasted to that of other developing Sub-Saharan countries Bilateral creditors, another major source of external credit for the country, has shrunk since 2010. However, Kenya negotiated for a US $600 million syndicate loan on favorable terms, an advantage attributed to improved macroeconomic climate in 2012. This saw commercial debt rise to approximately 10 percent at close of 2012 (IMF, 2013).
4.3 The Effect of Balance-of-Payments (Current Account Deficit) on FDI Inflows

4.3.1 Correlation Analysis

Guided by the fundamental objectives, this study seeks to determine the effects that fiscal policy has on the FDI inflows to the country. Balance of payments and particularly current account is an integral part of the fiscal policy. The null hypothesis, H0, is that BOP’s Current Account deficit has no implications on the FDI inflows to the country. Table 4.3 below shows that the correlation between FDI inflows and the BOP’s Current Account deficit is -0.063. This suggests that the correlation between the two variables under analysis is negative.

<table>
<thead>
<tr>
<th></th>
<th>FDI net Inflow of GDP</th>
<th>BOP’s Current Account deficit</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>FDI net Inflow of GDP</strong></td>
<td>Pearson Correlation</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>15</td>
</tr>
<tr>
<td><strong>Current Account Deficit</strong></td>
<td>Pearson Correlation</td>
<td>-0.063</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>0.013</td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>15</td>
</tr>
</tbody>
</table>

4.3.2 Regression Analysis of the variables

In this investigation, the $B_0$ is 1.583 and $B1$ is -0.085 as presented in Table 4.4 below. The $X$ value is BOP’s Current Account deficit while the $Y$ value is the FDI Inflows in the country. Based on the regression equation, this then implies that:

$$Y = 1.583 - 0.085X$$
4.4 The Effect of Government Development Expenditures on FDI flows

4.4.1 Correlation Analysis

Government development expenditure and in this case on infrastructure together with taxation and welfare policy, are asserted as “powerful economic agents” most modern societies. Development expenditure on infrastructure plays a key role in the overall fiscal policy. The null hypothesis, H0, is that expenditures on infrastructure have no implications on the FDI inflows to the country. The alternative hypothesis, H1, sets out that; infrastructure expenditures have a noteworthy effect on the FDI inflows to Kenya.

Table 4.5 below, confirms correlation between FDI inflows and the Development expenditure on infrastructure at 0.171. Consequently, this affirms that the correlation between the two variables is positive.
The analysis further reveals that a unit change in development expenditure on infrastructure in Kenya will translate to a positive net effect on the FDI inflows. Therefore a unit raise in development expenditure on infrastructure will result to an increase in FDI Inflows to GDP into the country by 0.171 percent. The significance of the relationship between the dependent and independent variables is at 0.610 confidence level.

### 4.4.2 Regression Analysis

In this investigation, the resultant $B_0$ is 0.441 while $B_1$ is 0.004 according to table 4.6 below. The X value is the Development expenditure on infrastructure while the Y value is FDI Inflows to GDP into the country. This then indicates the equation to this relationship is:

$$Y = 0.441 + 0.004X$$

**Table 4.6: Regression Analysis on FDI inflows and Government Development Expenditure**

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>95.0% Confidence Interval for B</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
</tr>
<tr>
<td>(Constant)</td>
<td>.441</td>
<td>.324</td>
<td>-</td>
</tr>
<tr>
<td>Development Expenditure</td>
<td>.004</td>
<td>.006</td>
<td>.169</td>
</tr>
</tbody>
</table>

The analyses of the variables reveal that the level of significance (p-value) is 0.608, is higher than the standard level of significance (0.05 percent). This implies that the existing relationship between development expenditure specifically on infrastructure and FDI inflows to the country is insignificant.

A further implication to this is that the value of FDI inflows to the GDP would be at the 0.441 percent mark even without development expenditure on infrastructure. However,
according to Table 4.6, with the impact of infrastructure expenditure, then with a unit increase in the infrastructure expenditure, then the value of FDI Inflow to GDP will be increasing by 0.004 percent.

4.5 Effect of Total External Government Debt to FDI flows

4.5.1 Correlation Analysis

Government debt (external) is a requisite and constitutive element of fiscal policy and thus the third variable in this research that typify fiscal policy amidst other variables. The null hypothesis, H0, is that total eternal government debt has no implications on the FDI inflows to the country, while the alternative hypothesis, H1, states that; total eternal government debt has a significant implication on the FDI inflows to Kenya.

Table 4.7; Correlation Analysis on FDI inflows and Total External Government Debt in Kenya

<table>
<thead>
<tr>
<th></th>
<th>FDI net Inflow of GDP</th>
<th>Total External Debt</th>
</tr>
</thead>
<tbody>
<tr>
<td>FDI net Inflow of GDP Pearson Correlation</td>
<td>1</td>
<td>.391</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td></td>
<td>.149</td>
</tr>
<tr>
<td>N</td>
<td>15</td>
<td>15</td>
</tr>
<tr>
<td>Total External Debt Pearson Correlation</td>
<td>-.391</td>
<td>1</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td></td>
<td>.149</td>
</tr>
<tr>
<td>N</td>
<td>15</td>
<td>15</td>
</tr>
</tbody>
</table>

Table 4.7 above, confirms correlation between FDI inflows and the total eternal government debt at -0.391. This implies that the relationship between the two variables is negative.

Therefore, a unit change in total external government debt it will have a net negative effect on the FDI inflows to the country. If the total external government debt was set to increase by a unit, then a -0.391 percentage increase in FDI Inflows to GDP in the country will be recorded. Equally, a net drop of total external government debt will result to decreased FDI Inflows to GDP by -0.391 percent margin. Table 4.50 also shows the significance of this relationship is at 0.149 confidence level.
4.5.2 Regression Analysis

In this study, the $B_0$ is 0.454 and $B_1$ is -0.013 as presented in Table 4.51 below. The X value is total external government debt while the Y value is the FDI Inflows in the country. This intimates that;

$$Y = 0.454 - 0.013X$$

Table 4.8; Regression Analysis on FDI inflows and Total External Government Debt in Kenya

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
<th>95.0% Confidence Interval for B</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
<td>Lower Bound</td>
</tr>
<tr>
<td>(Constant)</td>
<td>.454</td>
<td>.336</td>
<td>1.358</td>
<td>.211</td>
<td>-3.269</td>
</tr>
<tr>
<td>Total External Debt</td>
<td>-.013</td>
<td>-.015</td>
<td>-.164</td>
<td>-.532</td>
<td>-.080</td>
</tr>
</tbody>
</table>

The conclusions of the analysis further revealed that, the relationship between total external government debt and FDI inflows in Kenya for the period under study is insignificant. This is because the level of significance connoted by p-value is 0.602, which is higher than the standard level of significance (0.05 percent).

It is evident that under the 95% Confidence Interval; with no influence of total external government debt, then the FDI Inflow to GDP received by the country would be between the ranges of -3.269 to 6.143 percent. Nevertheless, Table 4.8 highlights that with the influence of total external government debt, any changes for which will affect the FDI Inflows to GDP by -0.08 to will result to a 0.044 per unit change annually.
4.6 Chapter Summary

Chapter four covered data analyses and presented a detailed overview on the effects of the various variables under fiscal policy on foreign direct investment inflows to the country by use of tables for a better and easier understanding. The researcher unearthed that two variables representing fiscal policy namely; BOP’s Current Account and Total External Government Debt have a negative correlation to the FDI Inflows to GDP. However, a positive correlation was observed between the Development Expenditure on Infrastructure variable and the FDI inflows to GDP. Chapter five will therefore present the conclusion and recommendations from the comprehensive analysis covered on this chapter.
CHAPTER FIVE

5.0 DISCUSSION, CONCLUSIONS, AND RECOMMENDATIONS

5.1 Introduction

This chapter provides a summative overview of the entire research with the aim of offering an in-depth discussion of the research outcomes with a view to fulfill the research objectives. Also, the chapter draws substantive conclusions regarding each research objectives and finally draws substantive conclusions and recommendations to aid future studies and for implementation. The chapter begins by outlaying a summary of the key findings made. The chapter then presents a detailed discussion of the findings in relation to each research objective. The third section draws conclusions and proposes recommendations base on the specific research objectives outline in chapter one.

5.2 Summary

The main objective of this study was to investigate the effects of fiscal policy on foreign direct investment inflows in Kenya for the period 2000 to 2014. The inquiry was guided by specific objectives namely: (i) To examine the effect of Balance-of-Payments (Current Account Deficit) on foreign direct investment flows in Kenya; (ii) To analyze the relative effects of government development expenditures (Infrastructure) on foreign direct investment flows in Kenya; (iii) To determine the effects of total external government debt on foreign direct investment flows in Kenya.

The research used descriptive research design in collecting and analyzing data. The study relied on secondary data collected from the Central Bank of Kenya (CBK), Nairobi Securities Exchange (NSE) database, United Nations Conference on Trade and Development (UNCTAD) Database, Kenya National Bureau of Statistics (KNBS) database and World Bank Database. The selected period under study was 2000 to year 2014 (15 years) and the data was aggregated annually. The means and standard deviation were calculated for all the variables under study. The data collected was analyzed by use of Correlation, Regression and Descriptive statistical analysis. A further analysis and presentation of data through charts, tables and figures was aided by use of Statistical
Package for Social Sciences (SPSS) version 22. The data analyses disclosed an assortment of results for the specific objectives outlined in chapter one of this research. A positive relationship was observed between government development expenditure (on infrastructure) and FDI inflows into Kenya. However, correlation between BOP’s current account deficit, total external government debt and FDI inflows into the country revealed a negative relationship.

The first objective of the research was to examine the effect of Balance-of-Payments (current account deficit) on foreign direct investment flows into Kenya. To realize this objective, this investigation regressed BOP’s current account deficit as fiscal policy variable against FDI inflows in the country. With a trend populated from a period of fifteen years (2000 to 2014), a definitive relationship that can be systemized was noted. The BOP’s current account deficit and FDI inflows shifted in the opposing directions. More so, the correlation coefficient between the two variables was at -0.063 mark, revealing a negative relationship between these two variables. However, this relationship is virtually insignificant for a solid conclusion to be made.

On the other hand, the second set objective was to analyze and establish the relative effects of government development expenditures (Infrastructure) on foreign direct investment flows in the country. The analysis revealed that there is some inclination between infrastructure expenditure and FDI inflows into the country with a trend in the same direction. With a positive correlation coefficient of 0.171, there was conclusive proof on a relationship observed from the trends over the fifteen years under study.

The third objective of this investigation was to determine the effects of total external government debt on foreign direct investment flows in Kenya. An analysis of the data for the period under study (2000 to 2014) revealed the variables tend to move in divergent directions. The relationship is negative with a correlation coefficient of -0.391 percent.
5.3 Discussion of the Results

5.3.1 Effect of BOP’s Current Account Deficit on FDI inflows

The investigation on the effects of BOP’s current account deficit on FDI inflows in the country revealed an insignificant relationship; implying that BOP’s current account deficit has no major effects on the FDI flows that Kenya receives. A nation’s international borrowing and lending; transactions in goods and services are registered in its balance of payments accounts. Hence, the current account balance is an account of a country’s dealings with the rest of the world (Ickes, 2008). A trade deficit occurs when a country imports more than it exports.

Orhan and Nergiz, (2014) examined the current account deficit setbacks in Turkey; the specific aspects and circumstances influencing the current operations which play a key role in financing the short-term capital movements. Their study also looked at policies to ensure the current account balance is defined and the effects of the current account deficit problem on the European Union accession and analyzing savings investments one should consider. The international flow of financial assets was included other than portfolio acquired by residents of a country through external lending and borrowing. The study revealed that there is a strong inverse relationship between account deficits and foreign investment inflows.

There’s likelihood of a nation’s Foreign Direct Investments flows to be nonaligned to its current account and other capital flows if the country’s foreign exchange system is liberal. Fry, Claessens, Burridge and Blanchet, (1995) interrogated FDI flows to 46 developing nations in an attempt to assess whether such flows are independent of the current account and other capital flows. The study, using Granger-causality tests revealed that the monetary authority’s requirement to surrender international trade proceeds lowered the chances of FDI being autonomous.

Also, the prevailing ‘custom-made’ exchange rates tagged on some capital account executions further reduces the prospects of FDI being sovereign to current account balances. The study confirmed that the prevailing relationship between FDI and current
account is observed only when FDI is linked with a substantial increase in capital formation when it is autonomous than when it is Granger-triggered by alternative capital flows.

5.3.2 Effect Government Development Expenditures (Infrastructure) on FDI Inflows

The analysis on effect of infrastructure expenditure on FDI flows into the country exhibited distinctly that the two variables have a significant relationship. The link is comparatively positive, with both variables being impacted in the similar manner.

Na and Lightfoot, (2006) analyzed the various factors including education, labor and infrastructure expenditure that determined FDI flows by region in China. The findings had a key role for both the central and regional governments as they guided authorities in resource allocation which facilitates FDI attraction. Research findings revealed that the level of infrastructure had positive relation to FDI. The study further provided that increasing funding for higher education and infrastructure, while stimulating transparency in state-owned enterprises may help identify and expose prospective areas for FDI to improve certain conditions in order to be attractive.

Kok and Ersoy, (2009) conducted a research on preeminent factors behind foreign direct investment in developing countries. Using panel data and cross-section seemingly unrelated regression (SUR) from economies of 24 developing nations for the period between 1976 through to 2003 (27 years) the researchers revealed that infrastructure had a positive influence on FDI inflows to the countries under study.

Kahutu, (1999) observed that growth in private investment is influenced by public investment. This is driven by rise in the demand of preeminent public services that give impetus to private sector development. Khadaroo and Seetanah, (2007) examined Sub-Saharan African economies with the aim to establish the relationship between transport infrastructure and FDI flows. With data for 33 Sub-Saharan African countries ranging from the period 1984 to 2002, the researchers employed both dynamic and static panel data analysis approach. The study findings revealed that in long and short-term
availability of infrastructure plays key role in boosting a country’s attractiveness of FDI inflows to SSA countries.

Asiedu, (2002) probed the determinants of FDI flows to developing nations analyzing the connection between infrastructure and FDI inflows to a country. By analyzing secondary data from developing nations using the statistical tool, regression analysis, she concluded that infrastructure impacts on FDI flows positively. However, all being constant; infrastructure stimulates FDI inflows to non-Sub Saharan African nations but has insignificant influences on FDI flows to Sub Saharan African countries. Also, Asiedu, (2006) tested on the connection between the same variables (infrastructure and FDI flows), a study incorporating 22 Sub-Saharan Africa nations over a period of 16 years (1984-2000). Using regression analysis, it was uncovered that well developed infrastructure was one ingredient that fostered foreign direct investment in most Sub-Saharan African nations.

Deutsche Bank (2013), in their report analyzing general spending of SSA countries observed that most SSA governments working to lower their infrastructural deficits which could otherwise inhibit their competitive advantage and hence growth. The governments are spending more towards infrastructure development especially after realizing that infrastructural deficits crushed firm-level productivity by about 40 percent and that investment in infrastructural development could stimulate GDP growth of the region by around 2 percentage points. The report by the bank further advocated for sustainable investment in infrastructural development as it is considered critical to maintaining economic development over the medium term period.

5.3.3 Effect of Total External Government Debt on FDI Inflows

Adepoju et al., (2007) examined Nigeria's high debt burden and its consequences for the both the overall wellbeing of the citizens and prosperity of the economy. Nigeria, since 1986 had resorted to limiting debt service not exceeding 30 percent of total oil proceeds, a move that did not provide much relief. The country dissipated over USD32 billion between 1985 and 2001 on servicing external debt. The study findings revealed that servicing of external debt caused servility on the economy as it invades the resources
available for poverty eradication and propelling socio-economic development but no significant direct relationship between government debt and FDI flows.

Iyoha, (1997) in his study, utilizing data from Nigeria reaffirmed that crowding out and the debt overhang effects of debt servicing are among the key factors that impact on private investment negatively. A study has shown that such effects have been observed in the Philippines after 1982. Iyoha gathered that these two effects evidently account substantially for the plummeting levels of investment in Nigeria. Edo (2002) also examined the predicaments of external debt in Africa citing Nigeria and Morocco. The findings of his study evidenced how critically external debt has affected investment severely.

The study further revealed that balance of payments (BOP), fiscal expenditure and global interest rate are the key constituents behind debt accumulation in the nations under study. Debt stock accumulation lowers prospects of the economy to thrive. This is through tax disincentive and macroeconomic instability (“debt overhang” effect). In instances where potential investors presume that their future incomes will be heavily taxed as a result of large debt stock, they are daunted and therefore shy off. Increased fiscal deficit, exchange rate depreciation, uncertainty and anticipated inflation are some of the factors that cause macroeconomic instability (Cleassens et al., 1996).

Audu, (2004) emphasized on the pertinence of “debt overhang hypothesis”. He put forth that the obligation of debt servicing has prejudiced Nigerian's expeditious economic growth and catalyzed the worsening of the country’s social problems. Deteriorating infrastructure as a result of poor funding has hindered service delivery (tailor-made to alleviate living conditions of the vulnerable groups) by the relevant institutions. A significant reduction of expenditure on social and economic infrastructure by government seemed to have indirectly restrained private sector investment and growth through lost externalities. This in the long run resulted in a plunge of total investment, since public investment is a significant proportion of the total investment in Nigeria.

Cohen (1993), Clements et al., (2003) also subscribed to the aforementioned effect of debt as they concluded that the negative effect of debt on growth not only through its impact on the stock of debt, but also through the flows of service payments on debt which
are likely to “crowd out” public investment. This is so because service payments and repayments on external debt soak up resources and reduce public investments that in the long run affect private investment inflows.

Greene and Villanueva, (1991) in their study on effects of debt service on private investment or the composition of public spending unearthed that external debt service dampens private investment. Serieux and Samy, (2001) also observed a similar correlation between debt service and total investment. Savvides, (1992) using a large number of heavily indebted poor countries-(HIPC)s noted that debt service crowds out public investment spending.

5.4 Conclusion

5.4.1 Effect of BOP’s Current Account Deficit on FDI Inflows

The study found that over the period under study (2000 to 2014), Kenya has observed an oscillating trend on FDI inflows, with a major slump in 2008 after a soaring mark in 2007. As evidenced by the findings, the implication of BOP’s current account deficit on foreign direct investment inflows to Kenya is virtually of less significance. BOP’s current account deficit and FDI inflows presented a shift in the opposing directions. This led to the conclusion that there was a negative relationship between the two variables under study (2000 to 2014).

5.4.2 Effect of Government Development Expenditures (Infrastructure) on FDI Inflows

The study findings indicated that although not major, there is a positive relationship between development expenditure on infrastructure and foreign direct investment inflows to a country. Despite the mild state of the connection between the two variables, the implication of the development expenditure on infrastructure is felt. In case of Kenya, the connection between the two variables seems to be depicting the aforementioned rationalization; that as the rate of expenditure increases; then it is comprehended that the
level of infrastructural development also upgrades as more funds are channeled towards the sector. This then implies that FDI inflows levels will grow gradually.

5.4.3 Effect of Total External Government Debt on FDI Inflows

The study revealed that after the oscillating trend and a plummeted inflow of FDI to GDP in 2008, the inflow started rising steadily from 2009, with 2013 recording the highest amount of inflows; however not as pleasing a result as one recorded in 2007. However, further findings on effect total external government debt period under study (2000 to 2014) revealed the variables tend to move in divergent directions. This led to a conclusion there was a negative and hence, an insignificant relationship between total external government debt and FDI inflows.

5.5 Recommendations

5.5.1 Suggestions for Improvement

5.5.1.1 Effects of BOP’s Current Account Deficit on FDI Inflows

The current government regime and even the previous governments too have not been keen on sorting out Kenya’s persistent current account deficit. Treasury has for a long time laid emphasis on curbing inflation and presumed that the current account deficit will be financed more or less indefinitely. Kenya’s current account is a major index about the country’s economic health. A positive current account indicates that a nation is a net lender to the rest of the world whilst saving more than it is spending. While the study revealed a negative, hence an insignificant relationship between BOP’s current account deficit, the link should not be ignored. The government should take tangible steps to adopt policies that are relevant to any nation that cannot finance current account deficits over the long run as easily as the developed countries seem able to. Kenya, having recorded persistence deficits for over three decades now can incorporate expenditure switching policies to turn around consumers' expenditure away from imports and redirect towards goods of local origin. Also, the country needs to develop expenditure reducing
policies, tailor-made to regulate demand in the economy and so reduce consumer spending in the economy particularly on imports.

5.5.1.2 Effects of Government Development Expenditures (Infrastructure) on FDI Inflows

Since the research evidently reveals that government development expenditure on infrastructure positively impact foreign direct inflows although not directly, it would be vital that the government allocates more funds to key infrastructural areas that accelerate trade and investments into the country. However, the government is on track with an array of flagship projects to stimulate economic development and boost the country’s attractiveness for foreign direct investment. The energy and power sector is well on course, with the Lake Turkana wind power project, the largest wind farm project in Africa. The transport sector, being the principal infrastructural building block; The Greenfield Terminal at Jomo Kenyatta International Airport (JKIA) estimated at Sh55.6 billion; LAPSSET- the Sh2 Trillion Lamu port-South Sudan-Ethiopia transport corridor; the flagship standard gauge railway project from Mombasa to Malaba. Konza Technology City, an ICT project worth Sh900 billion and identified as a key driver of achievement of Vision 2030. These are all capital intensive projects.

5.5.1.3 Effects of Total External Government Debt on FDI Inflows

In seeking the evidence on effect of total external government debt on FDI inflows to Kenya, the findings revealed a negative and hence, an insignificant relationship between the two variables. While this prevails, Kenya, like most third world nations tend to be characterized by considerably high levels of indebtedness, economic development can be stimulated the if the funds are utilized to finance investment in productive economic activities, more so to expand the productivity of the nation. The Kenyan government should develop a framework for systematic integration of ethics and economic development founded on strong structures and accountability through policies. Within the bounds of this framework, ethical matters should systematically be integrated into the primary constituents of the decision-making process for managing public resources. This should be geared towards sustainable economic and ethical development. Therefore the
recommended constituents to a sustainable framework include an optimal decision-making structure based on informed investment strategies, a promising path to fiscal sustainability through spending reforms that reduce outlays to improve allocative efficiency; better overall use of resources or productive efficiency and lower resource cost per unit of service delivery.

5.5.2 Suggestion for Further Research

Based on the analyses, findings, discussions and conclusions made in this study, it appears evident that this research could have improved its objectivity by incorporating more variables for analysis. Foreign direct investment remains a major source of income for most developing nations, Kenya included. The government's fiscal policy forms part of the determinants of foreign direct investment inflows. This study has related the two (Fiscal policy and FDI inflows) with an analysis of only three variables that make up the fiscal policy. This therefore grants for a further research on other variables of the policy and their implications on FDI flows in the country. Future studies on this topic should also seek to leverage on a wide scope of the period under study or different timelines in order to test for the deviations in the findings.
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http://doi.org/10.1080/10168730100000051


Table A.1: Data Collected for Fiscal Policy Variables and FDI (2000-2014).

<table>
<thead>
<tr>
<th>Year</th>
<th>FDI, net inflows (BoP, current US$)</th>
<th>GDP (current US$)</th>
<th>FDI, net inflows (% of GDP)</th>
<th>Averaged FDI net inflows (% of GDP)</th>
<th>BOP Current account balance (US$)</th>
<th>Development Expenditure (US$)</th>
<th>Total External debt (DOD, current US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>2,937,550</td>
<td>127,053,571</td>
<td>0.87</td>
<td>0.9</td>
<td>(237,565,099)</td>
<td>1,860,375</td>
<td>6,189,022,000</td>
</tr>
<tr>
<td>2001</td>
<td>2,302,623</td>
<td>129,860,074</td>
<td>0.04</td>
<td>0.05</td>
<td>(383,451,897)</td>
<td>1,884,435</td>
<td>5,566,284,000</td>
</tr>
<tr>
<td>2002</td>
<td>2,737,516</td>
<td>131,477,439</td>
<td>0.21</td>
<td>0.2</td>
<td>(177,203,456)</td>
<td>1,891,800</td>
<td>61,772,780.00</td>
</tr>
<tr>
<td>2003</td>
<td>7,626,242</td>
<td>149,045,176</td>
<td>0.55</td>
<td>0.5</td>
<td>(67,750,091)</td>
<td>196,343</td>
<td>69,227,320.00</td>
</tr>
<tr>
<td>2004</td>
<td>4,008,762</td>
<td>160,953,370</td>
<td>0.27</td>
<td>0.3</td>
<td>(370,424,651)</td>
<td>2,555,737</td>
<td>69,766,770.00</td>
</tr>
<tr>
<td>2005</td>
<td>1,757,601</td>
<td>187,378,954</td>
<td>0.11</td>
<td>0.1</td>
<td>(252,316,724)</td>
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<td>(510,433,478)</td>
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<td>2007</td>
<td>45,307,870</td>
<td>319,581,951</td>
<td>2.28</td>
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<td>(1,032,048,241)</td>
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<td>(1,688,505,911)</td>
<td>10,883,506</td>
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<td>(2,368,671,950)</td>
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<td>(3,830,376,411)</td>
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<td>0.3</td>
<td>(4,255,038,275)</td>
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<td>549,308,139</td>
<td>0.68</td>
<td>0.7</td>
<td>(4,871,711,579)</td>
<td>19,966,102</td>
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<td>609,365,097</td>
<td>1.55</td>
<td>1.5</td>
<td>(6,339,432,924)</td>
<td>20,064,547</td>
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Appendix 2: Raw Data (Checklist)


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<th>TED</th>
<th>GDP</th>
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Table B.2: Raw Data for Foreign Direct Investment Variables (2002-2013) in US$.

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<td>2014</td>
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</tr>
</tbody>
</table>
KEY:

**CA:** Current Account Balances

**DE:** Development Expenditure (Recurrent)

**TED:** Total External Debt

**GDP:** Gross Domestic Product

**FDI (IN):** Foreign Direct Inflows